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THE RUSSIAN FINANCIAL SYSTEM

BY

W. B. REDDAWAY

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PREFACE

Books on Russia and books on money have recently been produced in great numbers, but there is a surprising lack of books dealing at all comprehensively with the Russian financial system; I hope therefore that this little book will at least attract attention to an exceedingly interesting subject. It was written at the end of 1934 as an essay for the Adam Smith prize at Cambridge, and I have left it in its original form; consequently it must be taken as referring to conditions as they existed in that year. I have, however, added an appendix on the subsequent abolition of bread-rationing.

My material was almost all gathered at first hand in a series of interviews with officials of the State Bank in Moscow during August and September 1934; I should like to take this opportunity of expressing my appreciation of the courteous and helpful attitude adopted by all those with whom I came into contact.

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INTRODUCTION

In a country like Soviet Russia, where private enterprise as we know it practically does not exist, and the whole economic life of the country is regulated by the world-famous Plan, it is inevitable that the monetary and financial system should show radical differences from those employed elsewhere; yet there are so many other novel and interesting features of the Soviet system that this field of more or less academic inquiry has been left largely unexplored. One aspect of it has, indeed, received considerable attention—what might be called the peculiarities of the Russian shopping system. But the average writer seldom does more than explain the phenomenon of closed and open shops with vastly different price-levels, and perhaps touch on the difficulties of the foreign visitor, who will lose heavily unless he confines his purchases to Torgsin or faces the perils of the black bourse. He makes little or no effort to explain to his reader the why and the wherefore of these queer arrangements, or how it all fits together, and the latter probably concludes that the whole thing sounds crazy. At any rate, he is generally quite willing to accept the author's sole generalization—namely, that "the internal purchasing power of the rouble" is an expression which has no meaning (or at least no single meaning); and that consequently it is very hard to compare "real wages" in Russia and outside.

The object of this essay is to get away from these surface phenomena and investigate the problem in its entirety; to see how the monetary and financial system works, what functions it performs, and how it fits in with the rest of the national economy. It will thus be possible to examine both the similarities and the differences between this system and those in force in other countries; an attempt will also be made to distinguish between those differences which are more or less inherent in the notion of a State-planned socialist economy, and those which are due to purely local causes, whether historical accidents or acts of conscious policy.

To avoid controversy, I have confined myself almost exclusively to an investigation of principles; consequently the description will, in places, be one of what ought to happen, without very much reference to how efficiently the Russians have so far succeeded in putting their principles into practice.

CHAPTER I

THE RUSSIAN SOCIAL AND INDUSTRIAL SYSTEM

To appreciate the nature and functions of the Russian monetary system one must understand at least the framework of the social and industrial structure; this has, however, been dealt with in some detail by other writers, so it will be sufficient to describe it in very broad outline.

Almost the whole of industry proper is carried on by concerns owned directly by the State. Supreme control is exercised through four People's Commissariats, which are roughly equivalent to Government Departments; these have been set up for Heavy Industry, Light Industry, Timber and Food, and the necessary coordination is effected by means of the supreme Planning Commission. The Commissariats deal with questions of principle, policy and planning, and have under them so-called Central Administrations for each separate industry; these control and coordinate the work of the various subordinate organizations in the industry, help in the preparation of the plan, and are responsible for seeing that their section of it is fulfilled. The trusts, which come next in the hierarchy, are very important organs with a large variety of functions; they constitute the central organizations of groups of individual

factories (or other productive units) which manufacture the same class of goods. Sometimes they cover the entire industry of the country, but more often there are a number of trusts for different areas; in any case their offices are situated in the most convenient centre for their work, not necessarily in Moscow. They exercise very great control over the workings of their constituent factories, and for many financial purposes it is they rather than the factory which represent the unit. This scheme of organization is not universally employed (sometimes trusts are grouped into combines), but it is sufficiently typical to serve our purpose. Transport is organized on roughly similar lines—there are fewer intermediate authorities, but this does not introduce any new point of principle.

In agriculture, on the other hand, the direct State concern is the exception rather than the rule, though there are some very important State farms. The predominant form of organization is the collective form, which is nominally a voluntary association of producers working for their own account, owning their own cattle, etc. In point of fact they are subject to so close a control in various ways that their independence is strictly limited; what is important for our purpose, however, is that they are not paid wages by the State, but derive their income partly from consumption of what they themselves produce, partly from the sale of their surplus. The conditions of the sale of this are also of great importance (they furnish the key to some of the apparent contradictions of Soviet economics); certain fixed amounts (or in some cases, certain percentages of the crop) must be

delivered to the State, either gratuitously as payment in kind for various services, such as the use of tractors, or at a very low price. The remainder of their produce they either sell on the free market for what it will fetch, or deliver it to various State and cooperative organizations at intermediate prices; in the latter case they have valuable powers of obtaining a corresponding amount of industrial goods at so-called "political" prices. There are also a number of individual peasants, but they do not introduce any new principle.

The organization of distribution is a subject which would need very full treatment, were it not already fairly familiar. There are four main channels by which goods reach the final consumer—the open peasant market mentioned above; the cooperative shops; the factory shops; and the State so-called "commercial" shops. The principal features of these are:

The Peasant Market

This is subject to a certain amount of State control, but in general principles does not differ radically from markets in other countries. Purchases may be made without restriction as to quantity by anyone who has sufficient roubles to pay the price asked; but of course there is little for sale apart from raw agricultural produce, and prices are very much higher than those in the closed shops (often ten times or more).

Cooperative Shops

These are nominally consumers' cooperatives, owned by the members just as in other countries; the latter do

indeed have to subscribe capital, which bears the loss if the concern fails, but in fact the shops are very closely controlled by the State. They only sell to members, who have a card which entitles them to buy limited quantities of certain goods, and may obtain authorizations to buy others. These cards are granted to the member not as a member, but as a worker, and the cooperatives have no influence in the matter; the privileges vary according to the worker's industrial status.

Factory Shops

These are similar to cooperatives in that they sell only against cards, and at low prices; they differ in belonging to the State, and confining their membership to workers at a single large factory. We may perhaps include under this heading the State "public feeding trust", which supplies meals at similarly low prices to factory workers and others entitled to them.

Commercial Shops

These are State-owned concerns whose relations with the public are almost exactly the same as in a capitalist country; thus there are no restrictions on who may buy there, or what they may buy, and theoretically there is no more difficulty in obtaining any ordinary article than there would be abroad—*i.e.* supplies are, except in abnormal circumstances, sufficient to satisfy the demand at the prices charged. These are, however, extremely high—for products which compete with those sold on the open market they are necessarily about the same, and for others they bear a roughly similar relationship

to prices in the closed shops. As a result, although a great range of goods is offered (at any rate in the big towns), only the higher-paid workers can use them at all substantially, others only at very rare intervals or for trifles. (Strangely enough, soviet officials take considerable pains to minimize the importance of these shops and to emphasize how small a fraction of the population spend any money there; the reason for this we shall see later.)

Before we leave the subject of distribution, it should be noted that the resale of goods bought at closed shops for higher prices constitutes speculation, which is one of the cardinal sins in Russia. As a result, a worker whose "rations" include an article of which he is not in great need may not legally sell this at high prices and spend the proceeds in the State shops; the situation with regard to barter is not so definite, and in any case the position seldom arises, but theoretically this provision is bound to lead to waste, even if it corrects some abuses.

Finally, and in some ways most important of all for a proper understanding of Soviet finance, a word must be said about the organization of foreign trade. This is a State monopoly, both for imports and exports, and, to strengthen it, the State Bank is given the sole right to deal in foreign exchange, whilst the importation and exportation of Soviet currency are strictly forbidden. Special organizations have been set up to take complete charge of the trade in the various groups of commodities, and any concern wishing to import anything must apply to them. Their operations are strictly circumscribed by the section of the plan dealing with foreign trade, which

prescribes what may be imported, and allots certain amounts of goods to the exporting organizations; its aim is simply to obtain imports which will be of the maximum value to the country's economy in exchange for such goods as are available for export (including gold). Foreign trade in any case plays only a very small part in the country's economy, and it is conducted on principles which are almost wholly independent of internal monetary conditions, all calculations being made in terms of a fictitious gold rouble; consequently the U.S.S.R. may be regarded for all internal monetary purposes as a closed system, and is so regarded by those in control. Foreign trade is admittedly very important in certain respects, but it is so arranged that the country's monetary system is virtually insulated from all outside forces.

This in brief outline is the medium in which the financial system has to operate, and its characteristics will be determined accordingly; of course, in some cases the form of the industrial and social system has been influenced by the monetary system—we cannot say that one is fixed and the other adapted to it, or even describe one without some reference to the other (*e.g.* prices in shops)—but on the whole it is the former which has served as the basis. It is so different a system from that envisaged in most monetary discussions that it will be as well to pause a minute and study some general considerations which arise out of its characteristics.

Firstly, the fact that the U.S.S.R. is virtually a closed system is bound to lead to considerable differences between its monetary system and that of most other

countries; in one sense it creates a great simplification, and the notion of a closed system is of course perfectly familiar to economists. But it is important to emphasize the truly enormous difference which it makes; a technique of monetary management must be adopted which obtains little or no help from what used to be regarded as almost the only relevant considerations—the state of the exchanges, gold movements, discount rates at home and abroad, the balance of payments, etc. There will be none of the semi-automatic adjustments which come about through gold movements leading to a contraction or expansion of credit, or through movements in the exchanges where the gold standard is not in operation. An expansive monetary policy will not lead to an increased flow of imports to slow down the rise in prices and employment, nor will a deflationary one lead to increased exports. Those in control of the monetary machine have in one way an easier task than their confrères abroad, because they do not have to consider external repercussions; but in another their task is rendered more difficult and responsible, because these no longer provide so many semi-automatic danger signals, and variations in the balance of trade no longer act as a sort of safety-valve or shock-absorber to moderate the effect of credit policy on the domestic economy.

Secondly, we have the fact that many industries are directly owned by the State, and the remainder are under its control—a completely different state of affairs from the ordinary closed system envisaged by economists. As a result of this it is possible to control industry directly by means of a plan, instead of having

to pursue the indirect method of planning through central control of the monetary system. It would be obviously out of place to discuss here whether this is an advantage, or whether it is better to rely on individual initiative; but it clearly means that the monetary system will play a very different role in relationship to industry. The plan is designed to lay down what it is most in the social interest to produce, having regard to the productive resources of various kinds which are available; once this is done, the job of the monetary system is confined to rendering its fulfilment easier. Of course, as we shall see later, a good monetary system is almost essential both for drawing up the plan efficiently and for carrying it out, but from the point of view of the planners its role is definitely that of servant, and not of master.

Finally, we may observe that the State's position as a monopolist in so many industries enables it to use the monetary system as an instrument for reaching results which in other countries can only be achieved through the system of taxation, if at all; it may indeed virtually compel it to adopt methods and expedients which are almost impossible in other countries, to enable it to fulfil its responsibilities.

CHAPTER II

REQUIREMENTS OF THE MONETARY SYSTEM

WITH these general considerations in mind let us investigate the problem of what functions the monetary system should perform in order to render the maximum assistance in the preparation and execution of the plan. First of all, to take the extreme position originally adopted by the Bolsheviks, do we really need money at all in a system where everything is to be planned? Will not the plan simply play the role of the commander of a party wrecked on a Pacific island, and lay down what everyone is to do and how the fruits of their labours are to be consumed? Of course we soon find, as the Bolsheviks did, that a country with 160 million inhabitants cannot be run in the same simple way as our hypothetical coral island. The task of planning the activities of every one of them is manifestly impossible, even supposing they could be compelled to perform their appointed tasks in return for the reward allotted to them. Even if we ignore the difficulties inherent in this notion of forced labour, and suppose further that authority is delegated to separate organizations to arrange the details for each industry, it is apparent that a system of letting these indent for supplies and paying wages in ration tickets simply will not work. Nevertheless this sort of system marks the logical conclusion which we

should reach if we pursue the implications of planning to the bitter end, and some Bolshevik theorists still look forward to the moneyless State (though presumably only when there is such abundance of everything that waste does not matter).

Granted that a monetary system of some sort is essential to make the plan workable, what are the principal functions which we wish it to perform? First and foremost it must furnish a unit of account, without which it is virtually impossible either to produce a coherent plan, or to see that it is fulfilled. This will serve as a common denominator in terms of which resources of all kinds (skilled labour, unskilled labour, materials, land, tools, etc.) can be measured; it will then be possible for the planning authority to allocate resources in bulk to different uses in the form of grants of so many thousand roubles. Those in charge of each activity will then be left to use these to the maximum advantage, see whether other industries can really deliver the necessary supplies, and possibly make counter-proposals, which the supreme authority will have to coordinate with similar ones from other industries. The unit of account will also serve as a basis for costing, and so assist the compilers of the plan to determine what it really is in the social interest to produce—though they will still need some means of valuing the various alternatives. Thus if one man urges the construction of a gas-works, another that of a reservoir, the unit of account does at least enable the planners to make an intelligent comparison of the cost, and their problem is reduced to a comparison of values. The costing system

will also enable the central authority to delegate far more responsibility to their subordinates, making them almost independent as to details, but subject to a financial check as a test of efficiency; as an integral part of this, it serves as a basis for accounting between different enterprises. One has only to visualize the difficulties that would be experienced by the directors of Imperial Chemicals if they tried to run it without the aid of a monetary unit for costing and accounting between departments, to realize how essential this part of the financial system is.

The next function which we wish the monetary system to perform is to aid in the distribution of the limited supplies of productive resources to the maximum advantage. If the costing system is a really satisfactory one, this implies that there will be a certain force tending to bring this about; thus if the individual enterprise has to pay more for the services of a skilled engineer than for those of a raw novice, it will endeavour only to use engineers in jobs where they are really needed—and the same will be true of materials, land and other resources. This will be so whether the engineer gets any benefit from his higher wage rate, or indeed whether he ever receives it or not. Thus we may imagine a system of equal incomes for all, under which the enterprise is debited with the economic values of each worker, but payments are actually made into a central pool, out of which everyone receives the same amount. Under such a system the engineer would receive no tangible evidence of the higher rate at which his services were valued for purposes of accounting, and would be under

no incentive to make sure he was only used on skilled jobs, but the employers would be just as anxious as under ordinary systems. It is obviously unwise, however, to rely solely on this force to secure an economical distribution; the executive of a State trust could hardly be expected to see that no skilled worker was wasted on simple jobs, even supposing that it could compel each man to do whatever work was allotted him, and that its socialistic zeal, or the fear of punishment for incurring losses, induced it to put out its utmost efforts. It is advisable, in the interests of efficient planning and without regard to ethics, to arrange the monetary system in such a way that the individual is also materially interested in securing a job worthy of his skill; this is, of course, still more important where the extra value of his services is due not to natural talent but to training acquired at his own expense, for otherwise the supply of skilled labour may dry up.

Next on the list of functions which must be performed by the financial system is the provision of a means for distributing incomes and the reconciliation of supply with the consequent demand, both for goods in general and for individual commodities. In the field of production, since everything is under the control of the State, the allotment of supplies of materials is mainly done by plan. But when it comes to consumption, though we might theoretically have a system of rationing for all commodities, incomes being distributed simply in the form of ration tickets, this is most unlikely to be workable in practice. If incomes are distributed even

partially in the form of money and a measure of freedom of choice allowed in its disposal, then there will have to be some mechanism for adjusting supply and demand. This might be effected wholly by the adjustment of production, but if this cannot be regulated so exactly that the supply of each individual commodity is equal to the demand at the costed price, then some price variations will be essential, unless demand is artificially controlled (*e.g.* by the queue system).

The only other function which the monetary system must perform in the interests of planning and production is to provide an efficient means of making payments between enterprises and adjusting their financial relationships generally; since these concerns are really in the nature of departments of one huge concern, it is perhaps natural that the bulk of it should be done by means of book entries. From the point of view of the State as owner of them all, these mutual accounts are in a sense merely a "useful fiction", designed to keep a check on the individual concerns; but from the point of view of the latter they will be very much like their counterparts abroad. The individual factory will purchase supplies and sell its finished products, and from its point of view these transactions are perfectly "real", even if the other party to them is also a State concern—otherwise there would be no means of keeping accounts to check the efficiency of the different units, and the system of delegating responsibility would break down. Moreover, there may well be seasonal and other variations in the amount of capital which it will require, so that some means of granting credit will be almost

essential; thus the need for something very like a banking system becomes apparent.

This exhausts the principal desiderata of the monetary system from the point of view of "the authorities", if we include the implied requirement that it should assist in interpreting the consumer's wishes; from the point of view of the general public, however, there are others which are equally important. The individual citizen needs a medium of payment just as much as the producing enterprise, and since he cannot work by means of book entries, this must fulfil all the usual technical requirements of a capitalist currency—suitable denominations, durability, etc. He would prefer, of course, to have as much freedom of choice in the disposal of his income as possible, but however limited it may be, his need of a suitable currency is as great as elsewhere—if he is not given facilities for the use of cheques, perhaps even greater. The individual also wants the monetary system to provide him with an efficient means of accumulating a store of value—or, in other words, of giving him freedom of choice as to when he shall spend his income, at a cost that will not be prohibitive; and he would doubtless prefer that this freedom of choice should not be restricted to postponing consumption, but should include reasonable facilities for anticipating future income.

With this list of requirements to guide us we can now examine the system actually in force in Russia to-day; we shall find that it has been developed primarily with a view to facilitating efficient planning and production, without paying much heed to the interests of the con-

sumer as such. Of course this does not necessarily mean that the Bolsheviks have made the mistake of regarding production as an end in itself, rather than as a means of satisfying men's desire to consume, because the restrictions imposed on his freedom as consumer may be more than compensated by the increased output which they render possible. (Thus it is highly probable that the real interests of consumers in other countries would be promoted by restricting somewhat the almost complete liberty of the man with money in his pocket to spend it how, when and where he pleases, according to any absurd fancy that may possess him.) But in Russia the process has gone far beyond the stage of agreements to eliminate redundant models, restraints on the number of shops or traffic operators, and similar products of "rationalization"; in many cases the consumer's freedom of choice is so small as to be almost non-existent.

CHAPTER III

RUSSIAN FINANCIAL INSTITUTIONS

ALTHOUGH monetary conditions are in some ways so completely different in Russia, and the official theories even more so, the instruments of the monetary system are in form very reminiscent of capitalism. We need not say much about the currency, which shows the closest resemblance, even down to legal provisions for regulating it which seem to have no basis in logic. As a result mainly of historical accident there are two sets of notes—treasury notes for 1, 3 and 5 roubles, and notes of the State Bank in denominations of from 1 to 50 chervonetz (1 chervonetz equals 10 roubles). Since both issues are inconvertible and are accepted quite indifferently they really constitute a single issue, and in fact they are both now under the control of the bank. The old provisions are still legally in force—namely, that the bank-notes must be covered to the extent of at least 25 per cent by gold, foreign exchange and other precious metals (which are valued at the pre-war gold value of the rouble), and that the circulation of treasury notes must not exceed that of bank-notes. Under present circumstances these regulations have no economic significance whatsoever, and in practice the volume of the note issue can be varied at will. With the aid of subsidiary token coins the currency is used to complete

nearly all transactions in which a private person is concerned, and it does its work with reasonable efficiency.

The key position in the financial system is occupied by the State Bank, or Gosbank; this institution combines the functions of central bank, bank of issue and sole purveyor of ordinary banking facilities. At the head of its organization is the Central Administration in Moscow; this performs what in Russia corresponds to central banking, but it is a very different matter from central banking elsewhere. Russia is, in effect, a closed system, so that there is no question of using discount rates or exchange movements to preserve external equilibrium; similarly, industry is State-owned and is to be planned direct, so there is no question of using the ordinary instruments to control the volume of investment. Central banking in Russia means cooperation with the compilers of the industrial plan to regulate credit so as to assist in its execution; and regulating credit does not mean fixing a total volume for which individual enterprises may bid, but in drawing up an elaborate "credit plan" which ultimately lays down how much each enterprise may borrow, and even for what purposes. Needless to say, this is not all done centrally; the commissariats arrange a total figure with the Bank in view of their plans, and this is allotted to the Central Administration of each industry, which subdivides it between the trusts, which make the detailed arrangements for each factory.

Under the Central Administration there is the central head-office, which is simply a clearing centre, and 42 regional head-offices (one of which is also in Moscow).

The regional offices do some ordinary branch-bank work, but their principal function is to act as a link between the central administration and the 2400 branches and agencies. Thus they keep a check on these to see that they work efficiently, settle matters of lesser importance, and also act as subsidiary clearing-centres for banks in their regions. The branches do the ordinary routine banking, but in view of the detailed nature of the credit plan, they have little scope for initiative, and for the most part play a more or less mechanical role (keeping current accounts, making payments, taking in and paying out cash, checking applications for loans to see if they comply with the plan, etc.). For accounting purposes they are independent financial units, and the interest and commissions which they are allowed to charge must cover their expenses.

Every enterprise and institution must keep an account with the Gosbank, and its resemblance to the accounting department of a huge combine is shown by the use of these accounts to make all payments between enterprises which are of any magnitude. There are various technical methods of effecting these payments, but the points of principle involved are that no goods may be delivered until the recipient has given an order for payment, and the bank has certified that there are funds to meet it—no enterprise may grant credit to another, and no enterprise may be debited without its consent. Each branch keeps a giro account with its regional head-office, and another with the central head-office; payments involving two branches are effected through a clearing at the regional head-office if they

are in the same region, otherwise they go direct into the central clearing.

Besides the Gosbank there is a savings bank which functions in exactly the same way as other savings banks, except that all its funds, apart from liquid cash, are invested automatically in the State loan; in point of fact it is used mainly for very short-term savings—in 1933 the average deposit was withdrawn after five weeks. More important are the four long-term banks—for financing industry, agriculture, house-building and communal works, and the cooperative system respectively. These are the organs through which nearly all capital development is financed and controlled; as we shall see later, their functions are mainly the mechanical collection and distribution of the funds for this, both of which are done according to the plan, and the detailed supervision of the work to see that the plan is correctly and efficiently carried out.

Finally, a word must be said of the budget, which means much more in Russian finance than it does abroad. It includes far more than the ordinary revenue and expenditure on administration, defence, social service, etc., which go into the English budget; besides this, about 75 per cent of the country's total capital expenditure is financed out of the budget (mainly through the medium of the long-term banks), and in some cases the whole income and expenditure of State undertakings is passed through it. As might be expected in a country where industry is State-owned, the bulk of the revenue is derived from "taxes" on the various enterprises. Considerably over half is collected

by means of a turn-over tax, which is levied on all industries but falls most heavily on industries producing goods for final consumption—for the obvious reason that taxes on construction industries would necessitate correspondingly greater allocations of development funds, since the State is almost their sole customer. The next largest item is the special levy on the commercial shops (to be described later), the yield of which has been increasing rapidly; taxes levied directly on the population are unimportant from the point of view of yield, their purpose being mainly political (*e.g.* death duties rising to 100 per cent and heavy taxes on unearned income). The reason for preferring indirect taxes is simply the greater convenience of collecting revenue from State industry—the consumer must, of course, bear the burden, whatever system is used.

CHAPTER IV

THE ROUBLE AS A UNIT OF ACCOUNT

So much for what may be called the physical aspect of the problem; let us now investigate the vital problem of how the rouble functions as a unit of account, and whether it is an efficient one. People who are only familiar with the peculiarities of the retail market, with its multitude of price-levels, restrictions, etc., sometimes come to the conclusion that true accounting in Russia must be more or less impossible, or at any rate done according to completely different methods from those used in other countries; how, they ask, can you keep accounts in terms of roubles, when the rouble has all sorts of values, depending on who has it and where he uses it? In point of fact, however, arguments like this involve a complete *non sequitur*; we have already seen that there is no logical need for the unit of account in terms of which labour is "costed" to be the same as the unit used for distribution of incomes.[1] What is

[1] In case this notion seems strange, we may perhaps point out that this difference between the value to the recipient of his wage and the cost with which the employing enterprise is debited is not confined to Russia. In England, if one man's work is worth five times as much as another's, he will in general cost his employer five times as much. But as a result of our graduated income tax the purchasing power of his wage will be less than five times that of the other's.

required is that it should have a more or less uniform purchasing power over productive resources of all sorts (labour, fuel, materials, land, etc.) irrespective of which producing unit is using it, or what it is buying; if this condition is fulfilled, then a grant of a million roubles for the development of the coal industry will mean about the same in terms of real resources as a similar one to forestry; an amount of shoes which is expected to cost 500 roubles to produce will really represent a cost to society equal to that of clothes which are costed at the same figure, and their values can correspondingly be compared; and it will be possible to check the efficiency of individual managers and enterprises by measuring costs in terms of roubles.

Now it is not pretended that the rouble affords a perfect unit of account as judged by these criteria, but its defects are infinitely less than one would imagine from a study of the retail market. The foundation for a true unit of account must always be a system of money "wages" whereby the individual enterprises are debited with sums which really represent the relative economic values of the different workers; it is not by any means certain how far this condition is satisfied in Russia to-day, but there is nothing inherent in the system to make it impossible, and certain presumptions in favour of the errors being not impossibly large, taken in the aggregate. In the first place, the Bolsheviks have definitely abandoned the idea of equal incomes in favour of the principle that the reward of the individual worker shall vary with the value of the service he renders to the State—as is shown, *inter alia*, by the almost universal

adoption of piece-work, even in agriculture. Unfortunately, however, this is not sufficient, even supposing they adopted an economic interpretation of "value to the State", made the reward strictly proportional, and carried out their intentions efficiently; for it can be brought about either by giving the more "valuable" workers a higher money wage, or by giving him a good ration card and other facilities which do not increase his cost to the employing enterprise. In this way it is inevitable that some anomalies will arise; but in practice there is a general tendency for two possible sources of error to cancel out—a system of equal ration cards would render unskilled labour very cheap to the employer, but the custom of rewarding skilled workers with extra privileges has the opposite effect. If the Bolsheviks wished to make a man's real income strictly *proportional* to his economic value and still retain the present system of limited rations at low prices, then the requirement for accounting purposes is that each worker should be allowed to spend the same proportion of his money wage in the closed shops; if they merely want income to increase with economic value, but not so quickly, then the fraction should be a decreasing one.

If we assume that the system of money wages is sufficiently consistent to furnish the basis for a satisfactory (or at least usable) unit of account, then the rest is comparatively straightforward. At each stage of manufacture the goods are priced on a basis of covering the "planned cost" of production, which means the total costs (including overheads, amortization, etc.) of an average factory managed with reasonable efficiency.

There are some features which might not be regarded as quite in accordance with economic principles, notably the treatment of allowances for rent of land and interest on fixed capital, but it is doubtful whether these are sufficient to affect the validity of the costing system. Materials, fuel, etc., are of course charged for on this basis, so that the whole system is reasonably consistent —at any rate, there is no theoretical reason why it should not be made so, even if the principles have not yet been very efficiently put into practice. It should perhaps be emphasized that this system of costing is for the use of the authorities, to enable them to "know where they are" in a great many respects; it by no means commits them to selling the final products to the population at corresponding prices—if they wish to stimulate consumption of one article they may, and do, grant the industry a subsidy, or impose lighter taxes on it than on others. Moreover, if they allow a free market there is the demand factor which cannot be ignored; if supply is not sufficiently flexible exactly to satisfy the demand at the planned prices, then prices will have to be adjusted. Their position is essentially similar to that of a capitalist firm which manufactures a variety of products, and employs a costing system; this may be a great help to it in determining its price policy, but the management are in no way bound to base their prices on it—they may run one department at a loss as a matter of policy, or, more frequently perhaps, market conditions will necessitate deviations from the costed prices.

CHAPTER V

THE ROUBLE AS AN INSTRUMENT OF CONTROL

WE can now examine what is perhaps the most important and distinctive feature of the Russian monetary system—how they use this unit of account to promote efficiency, check waste, and control the performance of the plan generally. We shall find that although the monetary system is the servant of the central planning authority, it is made into a very stern taskmaster for the individual enterprise; in fact it is interesting to see how the Bolsheviks have reproduced artificially conditions very similar to the "ideal case" under capitalism—where the individual concern buys and sells everything at fixed prices (cf. perfect competition), and makes normal profits if run with normal efficiency. The control takes three main forms:

(1) *Control of Efficiency in Current Operations*.—This is secured by making each enterprise financially independent and laying down a scheme of prices for all its operations so that if it is worked with normal efficiency it will just cover all its costs (including overheads, amortization, etc.) and earn normal profits—a term which in practice needs no definition, since it is not based on any logical or economic principles, but is simply a convenient device for purposes of accounting

and control. Of course there is no way of recovering any losses that may be incurred by a State concern as a result of inefficiency; even in extreme cases where the enterprise becomes insolvent the only thing to do is to start again with a fresh supply of capital and a new manager; but this arrangement provides an automatic test of efficiency (the profit and loss account) and differs only in degree from the state of affairs where a joint-stock company is run by paid officials. Moreover, the penalties which the State can inflict on the manager in the event of such losses are a powerful stimulant of efficiency; whilst any extra profits that may result from good working may be used, at least in part, as a sort of collective bonus. This may be done either by extending the concern's operations (which should satisfy the worker's socialistic zeal) or by providing more material benefits in the shape of greater social amenities—clubs, gardens, crèches, etc.

(2) *Control of the Accumulation of Stocks*, whether of fuel, material or finished goods.—This might not seem important, and should theoretically be prevented by the interest charge involved, especially as the distribution of fuel, raw material and other essentials is all laid down (at least in outline) by the plan. But in point of fact it is notorious that Russia has been suffering from a shortage of materials of all sorts, made worse by an inefficient and overloaded transport system; in addition, prices of materials have been almost continuously rising, so it is not surprising that harassed managers have seized every opportunity of laying in stocks of anything which might prove useful, even if

only in the distant future. This has naturally accentuated the trouble, and led to the system of financial control, which is effected by giving each concern only a minimum of capital, and keeping a strict control of all forms of credit.

(3) *Control of All Forms of Capital Development*, with which is included all so-called "capital repairs".—This is secured by an almost complete centralization of all the available funds, including funds for major replacements, etc. Here we shall find how the idea of financially independent units is largely abandoned, funds being paid into a common pool and redistributed according to a coherent plan of development irrespective of their source.

When we examine the details of how these principles are applied we shall find that they work together to form a uniform whole in a manner which shows considerable ingenuity; the reader is reminded, however, that we are concerned in this essay with the investigation of principles, and little or no attempt will be made to estimate how efficiently they have been translated into practice.

CHAPTER VI

PRICE-FIXING AND CONTROL OF PRODUCTIVE EFFICIENCY

WE have seen that the efficiency of current production in the individual factories is checked by basing prices all through the system on the "planned costs" at each stage, and then examining their profit and loss accounts; it is obvious, however, that costs may vary considerably in different factories for reasons which have nothing to do with the efficiency of the personnel—age of machinery, lay-out of the factory, quality of power supply, transport facilities, etc., all have to be considered. Consequently if any uniform selling price were laid down for, say, cotton yarn of a certain count, to apply to all factories, some might be unable to avoid losses, whilst others would be able to make handsome profits without worrying about efficiency—in any case the automatic control would be lost. But if the price-fixing commission were to lay down different prices for each factory, the result would be to produce just those variations in prices for the same commodity which destroy the basis for the unit of account—besides being an almost superhuman task.

The way out of this dilemma is found by working with the trust as the financial unit; this has a selling organization known as a Sbyt which takes over the

entire output of all the factories, and sells it at a uniform price, which is laid down by the price-fixing commission. This price is designed to equal the average planned cost of all the constituent factories, together with a small allowance to cover the Sbyt's costs, and another (which may be very substantial) to cover the turn-over tax which constitutes the main source of budget revenues, and is paid direct to the treasury by the Sbyt. Of course, in the majority of cases the factories do not turn out one homogeneous product to be sold at a uniform price, but this is the principle of the arrangement; where there are small variations in quality, style, size, etc., the price-commission cannot possibly fix a price for each one, but lays down a standard price for a standard article, and the Sbyt negotiates with the purchasers to fix differentials for the other lines. Where there is a variety of distinct products the same is done for each —in every case the principle is that the trust's total receipts will equal the total costs, plus normal profits, assuming normal efficiency of management.

So far so good, but it is still necessary to apply the financial control to the individual factories. This is, however, a fairly easy matter, because the trusts are considered sufficiently responsible bodies to look after it themselves, especially as they will have to bear the losses themselves if they do not do it efficiently. The trust calculates for each factory what part of the price is needed to cover its current costs, assuming normal efficiency, *i.e.* the costs which it has to meet in cash either at regular intervals or so frequently that there is no need for central authorization (*e.g.* minor repairs).

Only this so-called "accounting price" is paid to the factory, the so-called "accumulation", representing depreciation allowances, funds for major repairs and profits, being paid direct to the trust. In this way the factory is put in the position of just being able to pay its way if managed with normal efficiency, and if it exceeds this standard it will accumulate a balance which it can use, at least in part, to its own advantage; the appearance of a loss in the accounts constitutes a *prima facie* case for a charge of inefficiency, though in practice, of course, it may be due to mistakes in price-fixing or unforeseen contingencies. The arrangement also has the advantage of concentrating all the "accumulations" in the hands of the trust, which is an essential factor in enforcing the other kinds of control.

This method of fixing prices is adopted right through the productive system, the finished product of one industry being passed on, duly priced, as the material of the next; when we reach the distributive system the principle is the same, but instead of the commission fixing selling prices direct, the various organizations (wholesalers, regional bases of village shops, and retailers) are allowed to add a certain percentage to cover handling costs and the cost of transport. The State commercial shops, which sell at much higher prices than the closed shops, constitute a special case; they buy their supplies at the same prices as the closed shops, but they pay a very heavy supplementary tax, which reduces them theoretically to the common position of being just able to make a normal profit if run with normal efficiency. In practice the adjustment cannot be made so accurately

as in other cases, because these shops are selling freely to the general public, and not to controlled institutions, or against ration cards, which both limit and, in effect, guarantee the volume of sales. Consequently the payment made to the treasury seems to be based mainly on actual results, and only very approximately fixed in advance to correspond with a theoretically attainable level of profits.

CHAPTER VII

SHORT-TERM CREDIT AS AN INSTRUMENT OF CONTROL

SINCE the State is legal owner of nearly all industry and effective owner of the distributive system, it is apparent that, from its point of view, the credit system is more like the internal book-keeping of a complex capitalist combine, rather than true lending and borrowing; but just as it is essential not to allow heads of departments to make unlimited indents and regard debts to other departments as of no consequence, so the State in Russia takes considerable pains to maintain financial discipline.

Each enterprise has been endowed with an amount of working capital which is (theoretically) just sufficient to cover its minimum requirements, *i.e.* its requirements at the season when the value of its stocks of all sorts, work in progress, etc., is at a minimum. Over this it has a certain amount of independent control, but it is supposed to divide it into separate funds for different purposes, *e.g.* stocks of fuel, material, half-finished goods, and to keep separate accounts under these heads. For its requirements in excess of this amount it must rely on bank credit, the distribution of which is governed by the "credit plan". This document is prepared in broad outline by the Commissariats and the central administration of the Gosbank, to act as a supplement to the

industrial plan; it is passed down through the hierarchy of the industrial administration, until it finally lays down not only how much credit each factory may have, but also divides this into separate allotments for each of the purposes described above. The bank will only grant credit if it is satisfied that it is for purposes which comply with the plan, and can recall its loans if it considers they are being improperly used; a diversion of credit allotted for one purpose to another for which the supply has been exhausted may only be made with the consent of the local bank manager, whilst an increase in the total requires the sanction of the regional head-office.

The relations between the bank and its client are as follows: each client has one current account with the bank, but in his own books he is expected to divide his capital into separate funds for different purposes, as explained above. If one of these becomes exhausted, it is temporarily possible to transfer funds from another; but as soon as the concern's total balance is exhausted and it wants to borrow, the manager must explain to the bank how its working capital has been used, in order that the loan may be entered under the appropriate head. The client's application for a loan must therefore show the amount required, purpose and maturity date, and give a description of its present stocks; this enables the bank to check both the solvency of the firm and the compliance of the details with the plan. If all is in order, the loan is automatically granted, and the amount is debited to the loan account reserved for that purpose. If the goods for which credit is required have already

been paid for out of capital earmarked for other purposes, a corresponding amount is credited to the firm's current account; if they have only been ordered, the bank pays the invoices and debits the appropriate loan account as before.

This is the normal procedure for so-called "planned loans"; "transit loans" are also given against way-bills to concerns supplying goods for delivery at a distance. They are automatically repayable at the end of the period needed for the goods to be delivered and notice of arrival to be received, plus two days; even if the consignee refuses to take delivery, whether because of poor quality or through lack of funds, the loan must still be repaid, and the consignor must make what use he can of them. However, according to an official Russian publication, it should never be difficult to find a purchaser if the goods are up to standard—which is probably true in view of the present shortage of supplies.

Finally, there is a third category known as unplanned loans; theoretically these should never be needed, but they are given in emergencies. It does not do to press Soviet officials too much on the subject, but the sort of thing officially visualized is the arrival of supplies at the end of one quarter instead of the beginning of the next, when credit will be available under the plan, or the temporary holding of goods for which transport is not available. The legal maximum maturity is one month, and in practice it is said seldom to exceed two weeks. Since they involve an increase in the permitted credit, the authorization of the regional head-

office must be obtained; how this can be done in time by banks in remote regions is hardly clear.

It is obvious that we have in this system the basis for a very thorough control of any unnecessary accumulation of stocks; since the enterprise's capital is limited to covering its needs at the seasonal minimum it will only be able to acquire extra stocks if it can obtain finance from elsewhere. But as we have seen, its amortization fund and even its planned profits are in the hands of the trust, so they cannot be misused, and no enterprise may now give credit to another (previously there had been considerable collusion between managers who resented the "discipline of the rouble" and this had rendered the planning of raw material distribution impossible). Consequently its only resort is the Gosbank, and here it must comply with very strict rules; there is no question of the bank's opening a credit on which the enterprise can draw at will—the bank merely pays the invoices, which it must first approve.

This system of allowing the enterprise only a bare minimum of liquid funds has the additional advantage of reinforcing the check on inefficient working by showing up losses almost at once; it is obvious, however, that it offers truly enormous scope for red tape and bureaucratic inefficiency. The possibility of granting unplanned loans in emergencies eases the position somewhat, but there is none the less a grave risk of perfectly legitimate business being held up by technicalities, especially in a country where managers are, possibly wisely, unwilling to show initiative if it involves a breach of instructions. It is perhaps significant

that a rider has been added to the rule about the transport agency being forbidden to relinquish possession of goods until the Gosbank has certified that the consignee has funds to pay for them—to the effect that this does not apply in the case of perishable goods!

CHAPTER VIII

FINANCING AND CONTROL OF CAPITAL DEVELOPMENT

VIRTUALLY the whole of the capital development in Russia is carried out under the central plan, and the finance is arranged accordingly. The plan covers major repairs and replacements as well as construction which is strictly speaking new, and correspondingly controls the expenditure of depreciation funds as well as new capital; in effect both investment and the saving needed to finance it are arranged on a gross basis.

There are good reasons in favour of this, both theoretical and practical; theoretically, it is clear that the funds which are accumulated as the result of including in the selling price an allowance for amortization are available for some form of construction in just the same way as funds resulting from taxes on consumption; there is no need to use them for maintaining the same factory, still less for keeping it in its present form. Practically, it will obviously lead to waste if the planning of new construction and that of major replacements are in the charge of different authorities, because the best opportunity for effecting changes or extensions is afforded when existing plant must in any case be replaced; moreover, on the financial side, it is essential to remove amortization funds from the control of the factory

managers to prevent their misuse, and this is done, in the first place, by paying them direct to the trust.

The principal source of funds for capital development is the budget; on purely income account this shows an enormous surplus, which represents "collective saving", and is applied to collective investment, mainly in concerns owned directly by the State. In addition the budget canalizes a certain amount of private saving in the form of semi-compulsory subscriptions to State loans and deposits in the savings bank, which are simply added to the common pool; there is little need to make a distinction between current income and capital receipts when the former substantially exceeds current expenditure. These budget funds are administered by the long-term "banks" (which in some cases, particularly the Prombank,[1] bear little resemblance to capitalist banks); the scheme for their distribution is of course laid down by the plan, and the principal function of the banks is to see that this is observed. In no case does the bank simply hand over the money to the beneficiary; if the latter is undertaking the construction direct, it will pay over enough for wages and petty expenses (though even these are checked against estimates, and also against wage-sheets to prevent fraud), and pay invoices for materials, after checking their conformity with the plan and the official price-lists. If the contract is being carried out by a third party (nearly always a State construction company) the bank makes all the payments due to it, and performs the same function of checking and controlling

[1] Bank for financing industry.

as before; of course, as is always the case with State concerns, there is no way of recovering the excess of the realized over the estimated cost, but the financial discipline enforced by the bank is a great check on irresponsibility and waste.

Besides these grants from the budget the long-term banks also obtain funds direct from the industries with which they are concerned; the bulk of the amortization and depreciation funds which are accumulated by the trusts have to be handed over to the relevant long-term bank as a non-withdrawable, non-interest-bearing "deposit". It is not quite clear how much attention is paid to the record of deposits made when funds are allocated to the different enterprises for capital development, but it is certain that where the concerns are owned directly by the State they have no powers over them whatsoever; all the funds are put into a common pool and distributed by the central authorities according to a coherent scheme of development, irrespective of their origin. The trusts have similarly to hand over a part of their planned profits, as well as paying part direct to the treasury; they can only retain enough money for repairs and developments of secondary importance, together with any additional profits which may result from efficient working.

Where the recipient is a State enterprise the grant is free of interest and non-repayable, though an allowance must be made for the amortization of the new plant or whatever it is, and the State will of course benefit from any extra profits; the whole transaction is much more like the investment of capital by a large concern in the development of one branch of its activities, rather than

the making of a banker's loan, and the function of the "bank" is simply that of agent and supervisor. In cases where the recipient is a municipality (for housing, communal works, etc.), a collective farm, or a cooperative, there is need for something more like a loan, because here we have rather more distinct ownership; correspondingly the deposits (of amortization funds, etc.) made by the bank's clients do not lose their identity to quite the same extent. Even in these cases the form of separate ownership is not as real as it looks, and a good deal of the financing, both in collection and distribution of funds, conforms to the above pattern; none the less the bank's funds are divided into those which they will ultimately have to repay, and those which are really in the common pool, and the former are used to grant repayable interest-bearing loans.

There can be little doubt of the theoretical advantages of this system of financing and controlling capital development, given full information and capable administration. The complete pooling of all resources enables them to be used wherever they will produce the greatest benefit, and so facilitates an even development of the national economy; in fact we have obtained, so far as one factor is concerned, that perfect mobility which is so frequently assumed by the exponents of equilibrium economics, and so seldom realized. Whether the central authorities can be relied on to judge what uses will produce the greatest social benefit without the guide of an "ordeal by rate of interest" is a little doubtful, but there is nothing to prevent their applying that test by calling on the various trusts to estimate what increase in profits

they will secure, and allotting the funds to the highest bidder. The sinking of amortization funds in new construction might appear to introduce a risk of a dearth of saving to finance the replacements if these happened to be concentrated in one year, but in view of the declared programme of progressive capital development it would always be possible to reduce the volume of new construction and devote the funds to covering the abnormal replacements.

On the practical side it was essential in the interests of economical production to have a responsible body supervising all major constructions; previously the view had been held by many that "economy" in construction was unnecessary in a socialist State because there was unlimited money available; the result had been appalling waste of material, and still more of labour. The most effective way of preventing this was by applying financial sanctions against the enterprise concerned (coupled, maybe, with sanctions of another sort against those held responsible) and with this end in view the long-term banks were given their extensive powers. Of course, as in all other attempts to enforce economy through financial discipline, there is always the danger of excessive red tape and the hampering of construction through insistence on the letter of the law; but on the whole the boot seems to have been on the other leg—operations have not in fact been suspended because there was no money authorized to pay for more bricks, but rather supplementary grants have been made too freely where funds have simply been wasted.

CHAPTER IX

FINANCE AS AN AID IN THE DISTRIBUTION OF RESOURCES

A. Of Labour

In the old "ideal" capitalistic system, with its perfect competition and perfect mobility of all factors, the distribution of resources to the maximum social advantage (as judged by "the market") was supposed to be effected automatically in response to the workings of the price system. Later economists have shown up some of the limitations, theoretical as well as practical, in the application of this doctrine, but despite increasing rigidities (trade-union restrictions, price-fixing and the like) we still rely on self-interest and the price system as the main forces in distributing the nation's supplies of labour, land, materials, etc., between different uses; moreover, although taxation has been used to an ever-increasing extent to modify the resulting distribution of income, we still take the system of money incomes derived from this process as the fundamental basis for our scheme of real incomes. The great advantages of flexibility which result from this method of decentralization and reliance on self-interest are well known; we have now to see how far the Russians have altered the system, and what they have put in its place.

It must be confessed at the outset that it is not easy to give a definite answer to this type of question. When one asks a Soviet official how, for example, the available supply of skilled workers or raw material is distributed the answer is nearly always, "It is planned", "It all comes under the plan", and it is of little use pursuing the matter further. But in the case of labour the Bolsheviks are very careful to refute any charges of compulsion, even in the sense of forcing a man to stay in any one job at the current wage, and indeed there are continual complaints about the excessive fluidity of labour; so it is clear that on this side there is considerable scope for the operation of supply and demand, the workman seeking the job in which the net advantages are greatest. On the other side, however, the employers (*i.e.* the individual State enterprises) are trying to choose those methods which will keep their money costs down to a minimum, and, as we have seen, money income and real income are far from being interchangeable expressions in Russia. Thus we get a potentially very important difference between the working of the capitalist price system and the Russian, which needs further investigation.

We have seen in our discussion of the rouble as a unit of account that this difference can be made to disappear by making privileges proportional to money income; for in this case the individual's endeavour to better his condition will take the form of seeking a higher money income in just the same way as under capitalism (subject in the same way to the qualifications set out by Adam Smith). If this condition is not

fulfilled, but privileges nevertheless do not decrease with increases in money income, the individual will still seek to obtain the maximum money income, but his incentive will be very much reduced; in this case the monetary system will help to secure the most economical distribution of *existing* human resources in the same way as under capitalism, but its action would be very much enfeebled, and might require assistance. Thus if everyone were allowed to spend the same amount in the closed shops there would still be an incentive to secure highly paid jobs, because these would bring greater real incomes; but, since the extra money could only be spent in the free market, a 10 per cent rise in pay would represent only a very small increase in real income, and the incentive would be a weak one. Moreover, unless the State took steps to prevent it (*e.g.* free training), there would be a serious risk of a future dearth of skilled labour, for there would be little to be gained by improving one's qualifications.

It is no part of my intention to discuss how far either of the above conditions is fulfilled in Russia to-day, but it is sufficiently certain that some exceptions exist to justify an investigation of the consequences. Theoretically, it is clear that if a man can get a greater real income by taking a job in which his money income (and so the cost to his employer) is smaller, then the harmony of interests is broken. To maintain the basis for our unit of account and the system of checking efficiency by means of costing, the man's money wage must be proportional to his economic value; but if we arrange for this, and nevertheless so fix the privileges on the ration

cards that the highly paid mechanic is worse off than the poorly paid labourer, then each individual will strive to get a low-paid job, and talented people will be wasted in simple occupations. Under this system, then, we must either jettison the basis of all our costing, or restrict the freedom of the worker to choose his own occupation; in either case the monetary system will definitely not help to bring about automatically an economical distribution of labour resources. Practically, it is most unlikely that the consequences would be so disastrous; it would be so obviously absurd to make real income decline as you went up the scale of skill inside any craft that no such system would be allowed to endure, even if introduced. The real danger is the possibility (and indeed the almost certain existence) of anomalies between different crafts; thus the original prejudice against non-manual labour might lead to the accountant in a concern having a relatively high money income, but very poor privileges. In this case he might be able to better himself by taking a very simple manual job, where his talents would be completely wasted, and he would seek to refuse the alternative of a rise in pay in his old job, even if it were offered; there would be a distinct tendency for the monetary system to lead to maldistribution of resources, especially if we consider the possibility of transferring to other enterprises. Moreover, even if we assume the State a sufficiently powerful monopolist to prevent this sort of waste of existing resources (coupled with the difficulty of changing one's occupation), there will still be a long-period tendency for people to avoid the ill-treated occupations;

failing a proper relationship of privileges to money income it is impossible simultaneously to secure:

(*a*) A sound basis for costing and a financial check of efficiency.

(*b*) An economical distribution of labour.

(*c*) Freedom of the individual to choose his occupation.

The natural suspicion of the man who feels all is not well with a currency with varying purchasing power would then be well founded.

B. Factors other than Labour

I do not propose to deal at such length with the effects of the monetary system on the distribution of other factors, because they do not raise so many points of interest. In the first place, the majority of them are in the hands of the State, which can therefore arrange their distribution far more by means of simple fiat—there is not the same need to consider the reactions of the terms imposed on the supply that will be forthcoming. And secondly, we do not get the same complications arising out of the multiplicity of price-levels in the retail market. We are mainly concerned with how the monetary system helps (or hinders) the compilers of the industrial plan to distribute resources over which they have almost complete control.[1]

The factors in which we are mainly interested are

[1] Supplies of agricultural produce constitute an important exception which is dealt with later.

land, funds for new capital construction, and supplies of all sorts (raw material, fuel, tools and other ingredients of working capital). We may say with confidence that they are distributed according to principles which rely far less on semi-automatic financial tests than is the case elsewhere—we may describe the system as "arbitrary" or "planned" according to our political convictions. The distribution of materials is so essential a part of the industrial plan that it obviously must be done with great care, but it is difficult to say much about it; they are supplied by the various State organizations at fixed prices (based on costs), so that the price mechanism cannot operate to determine it. The plan allocates the anticipated supplies to the different uses according to a sort of priority list, such as was used in the war; if supply were in excess of the demand at these prices production would presumably be curtailed, but this seldom happens except through mismanagement—some factories are said to have turned out vast quantities of simple products, for which there was no demand, so as to return a good record of output. In equilibrium of course there would be no need for this allocation of supplies, because the supply of orders at the fixed price would just suffice to absorb the output, fluctuations being covered by stocks. The forces tending to equilibrium are similar to those under capitalism, the difference being that excess demand leads to flat refusals instead of higher prices; those interested in something more realistic than theoretical equilibria must be satisfied with the idea of distribution planned in the social interest.

What one would like to know is how the Bolsheviks deal with day-to-day problems arising out of deviations from the plan, which admittedly occur. When, for example, there is a deficient output of coal or cotton, how is it decided which of the consuming industries is to get less than its planned quota? Or what happens to the allocation of supplies when one of the industries overfulfils its plan, as is periodically announced with such triumph? Clearly these questions are of vital importance, and much depends on the ability of a bureaucratic system to deal with them satisfactorily, but the way in which the adjustments are made is unknown; apparently the only way in which individual organizations can bid for the limited supplies available is by means of bribery —hardly a good way of relying on "the judgement of the market"!

There is similarly little to say about the distribution of land. Inside any one unit (particularly if it is a collective farm, so that the workers are directly interested), it will be used to the best advantage just as under capitalism. As between units it is doubtful whether any consideration of maximum rent is used to decide the allocation, and the actual charges levied are somewhat arbitrary; but it is by no means certain that such a process would yield a better result than is obtained by town-planning with little direct reference to finance. It is being found increasingly necessary in other countries to be guided by wider considerations than the purely financial, largely because development on one site affects the amenities and value of others, and charges cannot be properly allocated or collected. It is one of the advantages

of the Soviet system that land is all in one ownership, and useful improvements are not held up because of the difficulty of making the different beneficiaries pay their share.

Much the same may be said of capital, the distribution of which is made according to a plan instead of an ordeal by rate of interest. Here, however, it is more doubtful whether the planning method is so satisfactory, because it is so difficult to compare the social advantages of quite different projects of capital construction. Possibly the Bolsheviks calculate what rate of interest each would earn by assigning a value to the services it would render in the future—at any rate there seems no insuperable reason against it, and in view of the urgent need of new development in all directions, economy in the use of capital is essential. The great disadvantage of relying on judgement rather than a calculation of the return to be earned on rival forms of investment is the danger of forgetting the time factor; thus a closer attention to the question of interest would probably have moderated the over-rapid development of very large-scale construction, by emphasizing the remoteness of the benefits. We must remember, however, that nearly all capital construction comes under one central authority, so that it is not so impossible to prepare a plan without regard to the interest test as it would be in this country. Moreover, one of Russia's principal needs is better roads, the utility of which cannot be judged on profit-making principles, because they do not yield a direct financial return. Nevertheless the dangers of relying on judgement rather than some more mechanical

test are great. There is always the temptation to do something grandiose without really counting the cost, and too much capital may be devoted to those sections of the national economy whose representatives make the most noise. Of course, the absence of private profit-making and its attendant vested interests makes the position more tolerable; but there will always be influential men with "one-track minds", and it is probably true that the big towns get more than their share of improved public utilities.

The collection and distribution of agricultural supplies involves some financial problems that are peculiar to itself. In the case of State farms there are no special difficulties—the same procedure is followed as with all other State concerns; members of collective farms and individual peasants, however, are not paid wages by the State, but they sell a great deal of their produce to it, as explained in Chapter I. They are compelled to deliver certain (considerable) quantities at very low prices, and this constitutes, from their point of view, a rent in kind, together with some taxation, the money paid being sometimes not very much more than a receipt. After making these deliveries, and setting aside certain amounts for seed and similar purposes, they may also make supplementary deliveries to various State and cooperative organizations at higher prices; varying accounts are given of these, but in theory at least they ought to correspond roughly to the general level of controlled prices, for the proceeds may be used to pay for corresponding deliveries of manufactured goods. The transaction is, or ought to be, an exchange of

agricultural for industrial products performed through the medium of money; but the peasants have no guarantee as to the quality or quantity of goods that will be forthcoming, and complaints on this topic are numerous. Finally the peasants may sell their products on the free market, but in this case they enter directly into consumption, and so do not affect our immediate problem.

The problems which arise are twofold. Firstly, to make suitable financial and accounting arrangements when supplies are purchased at different prices; and secondly, so to arrange the conditions of sale for the different products as to be fair to the peasants, individually and collectively, and to promote the best distribution of their land and labour between different uses. The theoretical answer to the first problem appears to be simple; the higher price should be fixed as nearly as possible to represent the real cost on the same scale as is used throughout the industrial system and all organizations purchasing supplies at the lower one should make a supplementary payment to the treasury. The uniformity of the costing system would then be preserved, and the treasury would receive an appropriate rent for State lands. I have been unable to verify whether this is actually done, or whether the price is averaged over the whole crop, or whether things are simply left as they are;[1] in either of the two latter

[1] Judging by a complaint about "Soviet profiteering" recently made by the Riga correspondent of *The Times*, an addition must certainly be made to the nominal price. His argument that the high price of bread (as compared with the price paid for compulsory deliveries of grain) demonstrates the existence of "profiteering"

cases the costing system would be upset, but in many cases (*e.g.* grain for bread) the demand is inelastic, so that the undervaluation will not lead to intolerably wasteful use. With regard to the second, there is little to be said, except that the State does not rely simply on adjustment of prices to control the distribution of resources, but uses considerable powers of compulsion. It is doubtful whether this is very satisfactory, because general orders to increase the production of wheat by 10 per cent, for example, are unlikely to be enforced in the most economical way. It is obviously quite possible for the State to fix the conditions on which it purchases agricultural products and sells goods to the peasants so as to give them as a class a fair income in comparison with industrial workers; for individuals this can also be done by adjusting the rent, which in Russia means the compulsory quota. This then leaves the hard-working and skilled collective farmers free to earn a larger income, by increasing the output of their unit, or by increasing their individual share of it, since the joint proceeds are distributed (theoretically) on a strict piece-basis.

shows a complete misunderstanding of the position; though it may of course be true that the addition is too great, it would be wrong to make none.

CHAPTER X

DISTRIBUTION OF INCOMES AND RECONCILIATION OF SUPPLY AND DEMAND

THE next on our list of requirements is the provision of a means of distributing incomes, and the reconciliation of supply with the resulting demand. We have already seen by implication how the first part is achieved—industrial workers receive money wages (paid in currency just as in other lands), peasants sell their produce, and in addition there is the rationing system under which limited quantities of goods may be bought at low prices. There are also other sources of income, such as pensions, social insurance benefits and interest on State loans, but these are not important and mostly represent redistribution of income originally paid as wages; they constitute a complicating factor which can usually be ignored. It remains to see how the demand thus generated is satisfied.

Let us first examine the workings of a very much simplified model, in which all production is carried on by State concerns, and there is no rationing or closed shops, all consumption goods being sold freely in an open market. Under these circumstances the reconciliation of supply and demand would be a comparatively simple matter. The State would pay out wages to

workers of all sorts, whether engaged on production of consumption goods (in the broadest sense) or of capital goods, and these would be virtually the only form of income. A certain amount of this money will be taken back directly by the State in the form of direct taxes, excess of social insurance income over outgoings and payment for use of State property (principally houses).[1] The rest of the population's money income is available either for saving or spending, but in point of fact very little private saving is done in Russia apart from semi-compulsory subscriptions to the State loan. If we deduct these we are left with the total amount of money coming on to the market to buy State goods, since there is nothing else available. But the amount of these that will be forthcoming is determined by the volume of resources allotted by the plan to the production of final goods; thus the general price level is arrived at by simply dividing the population's spendable income by the supply of these goods, and its movements preserve an equilibrium between the demand for goods in general and the supply.

This is all perhaps rather obvious and formal (though it would need a lot of qualifications about temporary fluctuations in stocks, either of money or goods, before it could be regarded as pedantically accurate); what is possibly a little more instructive, as helping to solve the

[1] It is probably more logical to include rent in this category rather than regard it as the purchase of an ordinary commodity—

(*a*) Because in Russia it is fixed as a proportion of the worker's income, and so is a sort of tax.

(*b*) Because apart from maintenance there is no corresponding cost to the State.

more difficult problems presented by the system actually in force, is to examine the whole matter from the State's point of view. It will necessarily have an elaborate costing system, in order to keep a check on the workings of the plan, and for accounting purposes it will probably include in this a turn-over tax to provide the treasury with revenue; but when it comes to sell the goods to the population, if it adopts the principle of an open market, then the prices will bear no necessary relation to costs, either for single commodities or for goods in general. Similarly, for purposes of accounting and control it will make a sharp distinction between funds for capital development and money for current production, and see to it that each enterprise lays aside enough of the former, but in point of fact there will always be enough money forthcoming for any development plans the State decides to execute, provided they allow prices to find their own level, and keep wages fixed. For under these circumstances the weekly wage bill will be the same, whatever goods are being produced, and the population will have nothing to do with their money except return it to the State in one form or another—whether as direct taxes, or contributions to State loans, or in payment for goods, the prices of which are automatically adjusted to absorb the available spending power.[1] Looked at another way, the State decides what

[1] Needless to say this statement must be taken broadly; there may be temporary consumer-resistance to higher prices, and so an increase in the population's holding of cash, and various other time-lags. But if the State is the only equity-holder it can face these with equanimity, using the printing-press if necessary meanwhile; an inflation can only become cumulative if the State yields to demands for wage increases—but that subject must wait.

volume of resources is to be used for investment, and the saving must follow automatically in some form or other because the supply of consumption goods is correspondingly reduced. It may be done in all sorts of ways, and for accounting purposes the State rightly insists on the accumulation of amortization funds and the like; but so far as immediate effects are concerned it is a matter of indifference whether the finance is collected by direct taxes on the population, loans from the population (forced or voluntary), or from the profits of State enterprises (which may be made to appear at any stage and in any form). It will probably be as well to keep down the volume of loans, especially if they are voluntary and transferable, because they lead to budgetary complications and inequalities of wealth; but if contributions are on a more or less compulsory scale, varying with income, and the bonds are non-transferable (except in approved cases), then they are probably beneficial, within limits.[1]

So much for the general price-level; for individual commodities the reconciliation of supply and demand is also comparatively simple. If we regard the plan as irrevocably fixing the quantities of each to be produced, then of course there is no more to be said—adjustment

[1] This may indeed sound heretical in a land where State borrowing is bad, forced loans worse, and the virtues of transferability (and a Stock Exchange!) almost unchallenged. But where the State is paying for a great deal of capital development out of revenue it can afford to let the individual have some tangible evidence of his share in part of it, if only to satisfy the instinct for possession; compulsory subscription makes everyone have a comparable "stake in the country"; and restrictions on transfer prevent speculation and the accumulation of fortunes, and are essential in a land where death duties rise to 100 per cent.

will simply be effected through price-movements. But even so the plan would presumably have to be revised from time to time, and then the costing system would be important again; for it enables the planning authorities to compare the price realized with the cost of each article, and so facilitates the arrangement of a more desirable scheme of production. Of course they are not bound to be guided by these price and profit considerations—it is part of the socialist system that production should not be slavishly bound by "the market"—but if the price of one article exceeds its cost by more than the average proportion there will be a *prima facie* case for increasing its production. Moreover, in actual practice no retail market can ever be even approximately "perfect", so that adjustments do not come about "automatically" and the State cannot simply take up a passive attitude in the matter of price-fixing—it must establish some scheme of prices and will endeavour to use costs as a basis; and in any case no workable plan can lay down exactly what is to be produced, so that there will be some room for variations in supply, even within the planning period.

Let us now approach more closely to the existing system, by abandoning the assumption of a single free market; we shall still assume, however, that all production is carried on by State concerns, so that there are only two markets—the closed shops and the State commercial shops. Under this system a great part of the supply of goods would be sold at prices which did little more than cover their costs, together with such turnover taxes as the State might impose; consequently

nearly the whole of the surplus demand arising from the wages paid for capital development would be concentrated on the remaining fraction. The result is, of course, that the prices of these will rise considerably higher than the equilibrium level reached on our previous assumption. It is possible that these high prices may provoke an increase in saving by people who refuse to pay fifteen times as much for a second pound of butter as they paid in the closed shops for the first (or alternatively they may induce the population to spend every rouble to ensure getting something while they can); but apart from this the average price-level in the two markets (weighted according to the volume of goods sold in each) will be the same as on our first assumption, because there will be the same amount of money to spend, and the same volume of goods to buy.

Although the average price-level in the two markets is the same as before, yet it is most unlikely that the average price paid for any individual one will be the same as the price that would be reached in a single market. One obvious reason for this is the possibility that the proportion of the total supply of it which is sold in the closed market may be much greater or smaller than the average; to take an extreme case, if butter were only sold in the open shops, the average price paid for it would simply be the price in this half of the market, and so would be much higher than before. The division of the market into two parts will in fact upset all relative prices, however calculated. Under the new system the prices in the closed market could be fixed quite arbitrarily, because everyone will buy anything there to which

he is entitled (even if his need is not urgent), rather than spend his money in the open shops; in fact, however, they are based on costs, though the addition of a variable turn-over tax introduces a certain arbitrary element. The prices in the open market, on the other hand, are determined by the action of demand (reduced by purchases in the closed shops) on the remaining supply, and the scheme of relative prices so established may be absolutely different. Thus we get two sets of relative prices, differing from one another and also from the set which would be established if the two markets were amalgamated. In general the dispersion of prices in the commercial shops (reckoning them as a percentage of costs) will be greater than it would be in a single market; the reason is that the rationing system will allow people with small incomes who would otherwise have been outbidden to purchase a certain amount of the goods which are in short supply (this is, after all, one of the usual objects of rationing) and so provoke an even greater scramble for the remainder. One cannot, however, dogmatize on the subject—it might be that an unusually small proportion of these goods was sold in the closed shops, in which case the price in the commercial shops would be comparatively low.

It is not difficult to approach a step nearer reality by dropping the assumption that all agriculture is carried on by State concerns and substituting collective and individual farms which sell their produce to the State at fixed prices. Indeed, there is really no need to alter the general theory at all, because this simply amounts to a sort of piece-work system of paying wages; so far as

individual prices are concerned there is admittedly a certain difference, because this system of payment may either produce a greater incentive to agricultural production as a whole—a consideration which applies to any piece-work system, whether in industry or agriculture—or result in a diversion of resources from one branch to another. This is, however, not of great importance—the State has considerable powers of direct planning, even though it does not carry on the production itself, and can use these to supplement the control exercised through price variations. Thus the plan may lay down what areas are to be devoted to each crop, so that a farmer could not legally divert land to one which paid better. He might do so illegally and, of course, he can concentrate his labour and attention on the more remunerative crop, but it is doubtful whether the effects are quantitatively of any great importance. So long as the State can buy all its requirements at fixed prices and has the sole right to supply goods to the public, the details of the way it pays for them are comparatively unimportant; thus it makes no essential difference whether the collective peasants pay their rent in the form of deliveries at low prices or in a more normal way.

What does introduce an important new factor into the situation is the existence of the open peasant market, because this means that the State is no longer the only equity-holder, and does not reap the whole benefit of any profit inflation direct. If the State takes care to keep the supply of goods available in the commercial shops in a stable relationship to the money wages (including the "wages" derived by peasants from sales to the State)

left over to spend in them, then this will make little difference; for all that can happen is that the wage-earners will first pass their money on to the peasant, who will have nothing to do with it but hoard it (which is unlikely) or spend it in the commercial shops. There may be temporary complications and time-lags, but the existence of this intermediate transaction does little more than blur the sharp outline of the previous system—it barely affects the substance of it. We cannot, however, dismiss it so lightly in less stable times; if prices in the open market are rising—whether because money wages are being increased or because less consumption goods are being produced, or because a greater amount of them are being sold in the closed shops or for any other reason—then the money income of the peasants will also rise, and we shall expect their average cash holding also to increase. So long as this process continues the State will not automatically receive back in each week as much money as it pays out, and will have either to reduce its normal cash holding or issue fresh notes. Provided it does not allow money wages to rise there is no danger of a cumulative inflation, because the State's outgoings are fixed, and unless the decline in the supply of goods in the commercial shops is progressive, its income must ultimately cover these; but the existence of another set of entrepreneurs increases its anxieties during the interim period, and the greater the share of the free market supplied by private enterprise, the longer this will be. Looked at another way, if the supply of goods in the commercial shops is reduced the rise in prices will not at first be sufficient to maintain the

State's income, because part of the benefit will go to sellers in the peasant market. It is quite true that these will have more money to spend, and on the (fairly safe) assumption that they do not hoard it, equilibrium will eventually be restored with prices stable at a higher level; but for a time there will be an absorption of cash in this market and a corresponding deficiency in the State's receipts. If the private part of the market were large and varied there might be a considerable interval before the adjustments were complete, because the sellers would spend a substantial part of their increased incomes in buying goods from one another; in fact, however, it is extremely one-sided, supplying very little except raw agricultural produce; consequently there is a strong tendency for cash that enters it to come out again almost at once, because the peasant who receives it will want mostly industrial goods. This fact also reduces the extent to which it competes with the State commercial shops, and so the effect on relative prices—though the peasants will tend to demand different goods from those which their clients would have bought.

CHAPTER XI

THE INTERPRETATION OF DEMAND

So long as we imagined that all goods were sold in a single market it was obvious that the price system could operate to interpret consumers' demand just as in other countries; even if the plan were unalterable for a time, yet it could be revised at suitable intervals, when the planning authorities would have the automatic test of profitability to guide them. (In practice, moreover, production would have to be governed by demand to some extent all the time.) Of course this only operates as a guide to the public's preferences for different types of final goods, and throws little light on their desire for more or less capital construction; the amount of investment to be done is decided collectively by the State, which has always the power (revolutions apart) to call forth the necessary saving. As explained before, once the State has decided that a certain volume of real resources is to be devoted to capital construction, the general populace is economically powerless in the matter; the most it can do is to purchase the whole output of final goods, and perhaps induce the authorities to draw on any stocks that may be available. They can, however, refrain from spending all their money income, when they will probably still buy all the output, but at lower prices; the State will then finance its construction partly out of loans instead of out of profits.

When we come to consider a divided market, we might expect that this system of interpreting demand would be materially altered, even if it continued to work at all; but in point of fact the differences are not, at least in theory, so great as they might appear. It is of course no use studying demand in the closed shops, if we give "demand" its usual economic meaning, because everyone will buy there everything to which he is entitled. (Even here, however, demand in its purely vocal sense is a useful guide,[1] and a cynic might suggest that it should be measured by the size of the bribes offered to the management for procuring different goods.) But obviously it is possible to find out which goods command the highest premiums over cost price in the commercial shops, on the basis of the present outputs, and to revise them accordingly—in fact the authorities aim at keeping the prices of the different goods fairly stable at a planned percentage above cost, covering irregularities in demand by temporary variations in stocks. Thus there is obviously a way of interpreting the nature of demand as expressed under existing conditions; what remains to be seen is whether this will truly reflect the desires of the population.

This question is not quite so simple as it appears at first sight. We have seen that the system of relative prices in the commercial shops is not the same as it would be if all goods were sold freely in a single market,

[1] It must be remembered that the closed shops do not only sell daily rations of food, etc.; at greater intervals a member may generally buy clothes and similar articles, if they are available, and here some limited choice is allowed. Special supplementary permits may also be issued.

assuming all money incomes unchanged; it follows, therefore, that we shall not get the same answer by applying the price test in the commercial shops as we would by applying it in a single free market. This does not, however, of itself invalidate the argument, because the nature of a population's demand must always depend on the distribution of income, and the system of taxation through commercial shops is an essential part of the Russian scheme of income distribution; one might as well argue that the monetary system of interpreting demand in England is faulty because you would get a different result if surtax and a corresponding amount of transitional payments were abolished.

A far more substantial objection may be raised on the score that the consumer is not given a free choice as to what he will buy in the closed shops; if the arrangement was that each person might buy goods at cost price (including the cost of distribution) up to a certain value, then there would be no objection to the system, provided supplies of all goods were adequate to meet this part of the demand. But in actual fact, though he may have a certain limited choice with regard to some of his purchases, the consumer is for the most part allotted limited quantities of specific commodities; it may be that he buys certain commodities because they are supplied at reduced prices, when he would prefer others which could be produced at the same cost. Looked at from the State's point of view, it can always get rid of any surplus which may be depressing the price in the commercial shops by including it in the "rations", and there is no automatic monetary check on this sort of

waste; moreover it is aggravated by the fact that supplies in the closed shops are often deficient, in quality if not in quantity, so that there will not even be vocal complaints about an excess of any one commodity, the consumers being only too glad to get anything. It is doubtful, however, whether this defect in the system really amounts to anything very much in the aggregate, though it may be important in specific cases, because rations are mainly confined to necessities, such as bread; the population may grumble at being thus restricted in the disposal of its income, but there will be little material waste if they are merely compelled to have what they would want to buy in any case. Moreover, where there is a notable deficiency of one commodity, we may well get a more economical distribution by a planned system of rationing, rather than by trusting to the hazards of a highly imperfect market; it must not be forgotten that Russia is an enormous country, and that her retail market is consequently divided into a great number of more or less isolated parts. It would obviously be impossible for a consumer in Vladivostok to divert supplies of shoes from the Ukraine by bidding up the price, even if private trade were allowed; without the incentive of private profit it will be dangerous to rely solely upon monetary forces to determine the distribution of "deficit" commodities even between adjacent towns.

CHAPTER XII

THE CONSUMER'S SIDE OF IT

So far we have been mainly concerned with the monetary system as an aid (or otherwise) to the authorities in their task of planning and carrying out the national production; we have still to see how satisfactorily it meets the requirements of the general population in their capacity of earners and spenders of income.

As we have seen, employees of State concerns receive their income virtually under two heads—money that may be spent in the closed shops, and money which may not;[1] whilst peasants may themselves consume what they produce in excess of the compulsory quotas, or make supplementary deliveries to the State or cooperatives and bargain for corresponding supplies of industrial goods, or sell their products on the free market without this privilege. There is not very much to be said about the position of the wage-earner; theoretically he derives a total income which is calculated to be appropriate, having regard to the value of his work and his

[1] It ought perhaps to be explained that this money is not as valueless as might appear from a description of the shopping system, because it may be used to purchase services—tram rides, admission to exhibitions and the like; the prices of these are on about the same scale as those in the closed shops. The quality of some (particularly tram rides) is sometimes very poor; but the same may be said of goods in the closed shops.

family responsibilities. (The Russians have a simple way of arranging family endowment by allowing the married worker to make supplementary purchases in the closed shops.) In practice, however, there are considerable disadvantages in the system from the individual's point of view. He is bound in any case to be at the mercy of the State, because it has almost a monopoly of employment; but under the system of wage payments he is also entirely dependent on the ability of his cooperative to procure supplies of the goods to which he is nominally entitled. He has no reliable way of obtaining compensation if he loses a substantial part of his income through a deficiency in the quantity or quality of these, and it is little consolation to him to know that nothing has been wasted, another comrade having got the goods instead. Moreover, it is a recognized thing that he will be allowed to make supplementary purchases from time to time—it is clearly very difficult to have rigid rationing systems for durable goods; so that the individual is again at the mercy of the person responsible for issuing permits, and is almost sure to acquire grievances (real or imaginary). These disadvantages are in addition to those arising out of the restriction on his liberty to dispose of his income as he likes; as we have seen, these are not as serious as might appear, and most grievances are due more to the fundamental shortage of consumption goods than to the system of paying wages.

The notorious grievances of the peasants are due mainly to the application of the system rather than its nature. Theoretically they should be rather better off in the matter of economic freedom than the industrial

workers, because they have the power (within limits) to produce whatever seems most advantageous, and can dispose of their surplus over the compulsory quota in three different ways—personal consumption, sale on the open market or sale to government organizations. In practice, however, the compulsory quotas have been fixed so high (and the price paid for them so low) that the surplus has often been miserably small; a system which leaves the individual farm little or no appeal against unfair assessments is in any case unwelcome, as liable to produce hard cases, but the general level has been fixed too high. In addition to this the peasants have suffered particularly severely from indifferent and irregular supplies of goods in the shops. They have theoretically two ways of exchanging their produce for industrial goods (through the open market and through supplementary deliveries); but some are too far from any market to adopt the former, even if the commercial shops there were well stocked; and there is often no guarantee that they will in fact be able to buy what they want, or anything at all in their closed shops.[1]

Both classes have suffered somewhat from the lack of any reliable means of accumulating a store of value. It is possible for the individual to save by hoarding cash, or depositing it in savings banks, or by subscribing to the State loan—the last being virtually compulsory. But all these involve exposing his wealth to the vagaries of the rouble, and the State loan is not even readily

[1] In practice the peasant seldom buys at a true commercial shop, but obtains additional goods at higher prices from his cooperative; the supply of these is erratic in the extreme.

saleable in case of need nor usable as security for a loan from a bank or pawnshop. As a result the individual generally tries to do his saving, so far as he does any, by purchasing durable consumption goods which he can, if necessary, pawn or sell through the State commission-shops. It is obvious that this state of affairs is not very satisfactory, but it is doubtful whether it is quantitatively very important; the Russians have a fairly comprehensive system of social insurance, which reduces the need for personal saving, and the number who have a large enough money income to want to save is very small. There is of course no need to rely on private saving as a source of new capital; and the comparative stabilization of prices on the free market, coupled with the much improved supply of goods, should lead to increased confidence in the rouble. It will still be prohibitively expensive to save any money that might be spent in the closed shops; but few people have the right to spend so much in them that they would want to save part.

As regards facilities for forestalling income, it is almost unnecessary to say that private money-lending is a cardinal sin, but probably exists; apart from this the commission-shops offer a means of selling furniture, clothes and the like, and there is a limited amount of public pawnbroking. Certain durable goods may also be purchased on the instalment system, but it is doubtful whether this practice, though growing, is at all widespread; otherwise the rule is strictly cash.

CHAPTER XIII

SOME GENERAL CONCLUSIONS

THIS concludes our survey of the function of the monetary system in its various aspects, and it only remains to make a few general observations about the working of the system as a whole, and some comparisons with other countries. As was to be expected, the principal differences arise out of those peculiarities of the industrial and social system which were set out in Chapter I—the fact that Russia is virtually a closed system; that the whole economic life of the country is regulated by a plan, and is largely carried on by State-owned concerns; and that the State makes use of its monopolistic position to achieve various ends through the monetary system, in a manner that is in some respects very convenient, but by no means essential to the notion of State-planned Socialism.

Probably the most characteristic feature of the Russian financial system is the extent to which the State relies on "direct action" rather than indirect control through finance and the price mechanism. This is seen in the direct planning of new investment with little or no use of the rate of interest, either as a controller of the volume of saving, and so a judge of the optimum total amount (a function which it performs very indifferently), or as a selector of the most eligible

schemes (which it does better); in the distribution of raw materials, land and other factors between different industries; and indeed in the whole system of planning. Even in its policy towards labour, where the State relies very considerably on the financial incentive to produce results, it adopts the policy of direct action in such matters as training of engineers at its own expense (not to mention the truly "forced labour" supplied by G.P.U. prisoners on the Baltic–White Sea Canal and elsewhere), rather than the liberalist method of allowing the scale of reward to rise until it called forth an adequate supply. In carrying out such a policy the State is greatly assisted by the fact that it is almost the sole entrepreneur—and conversely this fact renders direct planning more or less essential, because there are no rivals to constitute a market (though the State might let the various trusts bid against one another). This helps in a great number of ways; there is no need to worry about the effect of any policy on the profits of any one section of industry—they may be temporarily allowed to be enormous, or be reduced to nil without raising protests from vested interests; the State can know the entire facts of an industry when planning its development, and there will be no danger of rivals entering it on the basis of incomplete information and wasting the capital of all concerned;[1] and the State can

[1] In this respect the system differs in two distinct ways from capitalism—the availability of full information, and the absence of interested parties; "planning" a privately owned industry almost inevitably resolves into controveries about "fair" or "reasonable" prices, and an endeavour by vested interests to keep out competitors, however justifiable their presence might be.

safely invest capital in the training of men without the risk of their subsequently joining or starting another firm.

The feature which has attracted so much attention—the rationing system and the existence of various price-levels—is not an essential part of the system, and there seems to be some prospect of its abolition; already the prices in the commercial shops have been reduced somewhat, and a far better supply of goods maintained (at any rate in the big towns). The reasons for its introduction are complicated and, to a great extent, it "just growed" without any coherent plan; it probably owes its origin as much to confused thinking as anything else. As believers in the labour theory of value, the Bolsheviks considered the price of any article could be deduced from its cost without any reference to demand. If an adequate addition had been made in calculating the cost to cover the State's expenditure on new construction and other work which did not immediately add anything to the supply of final goods, then there need have been no disequilibrium between supply and demand for consumption goods *in the aggregate*; even so, there would almost certainly have been maladjustments in the supply of individual commodities, and failing either a rationing system or a movement in prices the distribution of those in short supply would have been largely a matter of chance—depending on the purchaser's influence with the authorities, his endurance in standing in a queue, or the district in which he lived. Such a state of affairs would clearly have been unsatisfactory, especially in view of the size of the U.S.S.R.

and the consequent division of its retail market, but if it had not applied to too many articles, the position would not have been intolerable; everyone would at least have been able to spend the whole of his income on something, and the man who simply had to have butter and had been too far down the queue would probably have found a "speculator" who was willing to supply him, whatever the law might say.

In fact, however, the allowance made for the enormous volume of construction work was wholly inadequate, and the fall in the price of Russian exports made matters much worse by reducing the supplies available at home. As a result there arose a situation which really was intolerable—prices in the State shops were kept fixed, and the supply of goods was so much reduced that it was no longer adequate, or anything like adequate, to absorb the whole of the public's money income. People who were desperately in need of goods of all sorts were left with money in their pockets which they simply could not spend—or could only spend in the peasant market, which was only tolerated as a temporary survival. The times were so chaotic that the system of distribution brought about by allowing prices to find their own level would probably have been unsatisfactory, besides being against Bolshevik principles; so a rationing system was introduced and the commercial shops extended as the need to provide an alternative outlet for surplus cash was realized.[1] They

[1] A very important practical reason for the introduction of rationing was to increase the control of the State over the labour market; its ability to deprive a worker of his ration card made the

are not, however, regarded with favour by the official apologists, who still like to regard the closed shop prices as "the" prices; hence their anxiety to assure the inquirer that these shops only affect the fringe of the population and so constitute only a minor blemish on the system.[1]

If we look at it from a rather more realistic standpoint, there were several advantages to be gained by the rationing system. It produced some sort of order at a time when the system of distribution was in chaos, and provided a convenient way of adjusting the system of real incomes; it ensured that nobody got too much of the reduced volume of present supplies, even if it created some future problems in the shape of accumulated claims on society; and it provided an automatic means of heavily taxing any money income derived from illegal sources. (At the time this was principally important as a means of destroying the relics of private production, by

Government's wishes almost irresistible. In particular the rationing system reduced the very great turn-over of labourers moving from town to town in search of better conditions (which did not exist) because it tied the worker to the neighbourhood of his cooperative.

[1] It is quite impossible to get a Soviet theorist officially to admit either that the rouble is depreciated or that the closed shop prices do not measure its value—at any rate "very nearly". The peasant market is dismissed as "outside the socialized sector" and therefore of no account; the fact that the black bourse rate is 200 roubles to the £ as against an official rate of about six is no evidence of depreciation, because such transactions are illegal. The commercial shops are harder to explain, but the fact that people are willing to buy goods at prices ten times as high does not show that "the" price of butter is not the price in the closed shops—there is merely a temporary shortage of goods, because so much energy is being devoted to new construction. The comrades should wait until the fruits of this are garnered, and buy State loan meanwhile.

rendering money incomes derived from it practically worthless; it now operates mostly against the less desirable forms of private enterprise, such as bribery.) The complaints against the system arise largely from unfamilarity and misconceptions; mankind is so used to the notions of unrestricted purchases and freedom of choice that any interference with it is considered an imposition. The fact that he is only allowed to spend a part of his income in the closed shops is regarded as a sort of fraud perpetrated by the State—everyone thinks how much he would gain if the limitations were abolished, quite ignoring the fact that if it applied to everybody, the closed shops prices would inevitably rise. Then there is the instinctive human belief in a commodity's having one price ("the proper price"), and the consequent objection to the existence of two; this applies still more where some people are allowed to buy certain goods in the closed shops, and others are not.

This last objection raises a point of some theoretical interest. Included in the list of functions of money which appears at the beginning of every text-book on the subject one finds "to serve as a standard of value"; in the Russian retail market there are two different sets of prices, giving two scales of values which differ in their internal relations as well as in their absolute magnitude. What, then, are we to say about such a state of affairs? Is the rouble a standard of value or not, and if so, which set of prices are we to use? If it is not, what, if anything, does anybody lose by it, or what takes its place? The answers to these questions are not so difficult as might

appear, but in each case we must consider what it is we really want to do. Thus from the point of view of the consumer money serves as a standard of value if it enables him to compare the merits of two alternative courses (usually, two ways of spending his income); in Russia he receives his income in two parts—one that may be spent in the closed shops, and one that may not. In spending the latter, he obviously uses money as a standard of value just as his British counterpart does; and so far as he has any choice in spending the former, money also serves as a standard of value, operating on a different scale, but in the same manner. Thus from the consumer's point of view the rouble is quite a good standard of value, but he has to use two scales; a complication would arise, however, if he preferred to spend some money in the free market which he was entitled to spend in the closed—as might happen, for example, if his card allotted him too much of one commodity, but it seldom does in practice. Even here money would serve as a standard, but he would have to use a compound of the two scales, and the position is further complicated by the possibility of his "speculating" with (*i.e.* reselling) his unwanted rations, as is frequently done with such things as cigarettes. Economically such a process is of course perfectly justifiable, though it is illegal. From the point of view of the State a standard of value is needed to guide it in deciding on what to produce; the problem falls into two parts—measuring the cost of producing various alternatives, and measuring their value; we have dealt with the former in discussing the rouble as a unit of account, and the latter in discussing the interpretation

of demand.[1] In effect money does serve as a standard of value for all the main purposes where one is needed for making a decision. It does not serve as one for such purposes as comparing the real incomes of two workers; but in this and most other cases there are also objections to doing the same thing in other countries—the need for taking net advantages rather than money income is much greater in Russia, but is not peculiar to it.

Both this system of rationing and the system whereby the peasants dispose of their produce are by no means essential to the notion of planned Socialism, but merely convenient devices for reaching desired ends. What is more characteristic of such a system is the way in which control over individual concerns is maintained by means of price-fixing and the control of credit and capital. The historian would probably find a most interesting occupation in examining the varying opinions which have been held on this subject, and the adjustment of financial relationships generally. He need not perhaps concern himself overmuch with those who considered that "economy" was only necessary in spending valuta because the supply of roubles was unlimited; but apart

[1] This division is really an over-simplification of the problem, because it involves some circular reasoning. In our costing system we price the different factors according to their "economic value"; this is, however, not something inherent in them, which is independent of policy, but depends on what it is decided to produce. We cannot therefore simultaneously say "We decide what to produce on the basis of our costing system", and "We decide our costing system on the basis of the demand arising out of the plan of production". The exact method of mutual adjustment would take us too far from the subject.

om this there have been continual variations between iose who said "What does all this mutual accounting iatter when everything really belongs to us? (*i.e.* the itate)" and those who insisted on strict financial dis-ipline. It sounds very plausible to say that it is absurd o hold up delivery or production of real things merely ɔecause the relevant enterprise has exhausted its credit, which is only a sort of financial jugglery, and, as we iave seen, some relaxation of the strict letter of the law ias been allowed in the case of perishable products; but it seems now to be recognized that financial control is essential to supplement the plan and to secure efficiency. Some anomalies may arise, but since the plan cannot hope to go into minute details (*e.g.* the exact distribution of materials), control of credit is the only available method, and these have to be tolerated; once more, the fact that all industry belongs to the State renders the task much easier, because justice to individual enterprises is not so important.

Another characteristic feature of State socialism is the ability of those in control to ignore considerations of demand in fixing prices for bargains at all stages up to the last—*i.e.* the one at which the product is sold to the public. In this respect its practice resembles that of various integrated concerns, in which the product is passed forward between departments at costed prices, and finally sold at a price which depends on "the state of the market"; the reason is the same in both cases—the intermediate bargains do not really represent a change of ownership, but records are needed for purposes of book-keeping and control, and as a guide to

possible changes in policy. Where the Russians erred was in their attempt to apply this method also to the last stage, irrespective of the state of demand—though they can do this, within wide limits, in the closed shops. The resemblance between the Russian productive machine and an integrated concern is also shown in the general lay-out of the financial system, with its single bank to correspond with the accounting department. The great difference is of course that few concerns are so large as to produce the whole output of a commodity through all its stages, and none supplies the entire wants of a whole population; hence none are so directly concerned with the effects of their actions on demand.

The Russian monetary system presents in some respects a relatively simple subject for theoretical analysis, and its working throws some light on points which are of interest in modern monetary theory.[1] It operates in what is virtually a closed system, and there is only one "cheque-issuing" bank, which also controls the note issue, so that its power to regulate the volume of deposits is unquestionable. There are, moreover, very few possibilities of carrying on any transactions on the basis of any other sort of credit, so that no complications can

[1] Two examples are: (*a*) The practical illustration provided by the first five-year plan of Professor Hayek's imaginary nation which sunk all its capital in a vast machine which could not be worked owing to lack of circulating capital; and (*b*) the way in which the Russians have been led by hard experience to the same conclusion as several Cambridge investigators into problems of saving and investment—namely, that it is gross saving and gross investment which are of importance,—and have arranged their financing of capital development accordingly.

ise through the Bank's restrictive policy, for example, ›ing thwarted by increased use of book debts. Above l, the existence of one entrepreneur of dominating nportance simplifies the application of saving and ıvestment technique enormously, and there can be ttle doubt that this is the easiest and most helpful way f approach. As we have seen, so long as the State llows prices to rise and keeps money wages fixed, no nflation can be cumulative, and prices will soon reach ı level compatible with the volume of investment, ılmost irrespective of the policy adopted in the interim; ınlike inflations in other countries, an inflation in Russia facilitates the collection of revenue, because the only way people can get rid of money is by handing it in some form to the State (ignoring the temporary complications caused by the peasant market). Neither of the usual irritants—the chronic bankruptcy of the treasury and the feverish desire to pass on money—can operate for long, because they cancel one another out, so long as the State does not let its expenditure rise by raising money wages; rising prices will raise the State's income until its saving is sufficient to balance whatever volume of investment has been decreed.

I have been careful to reiterate the qualification "so long as money wages are not allowed to rise" because it is supremely important. It is obvious that the community's real consumable income is determined, assuming full employment, mainly by the proportions of real resources devoted to producing capital and consumption goods respectively; it is theoretically possible to draw

upon stocks, but this is only a temporary device, and in Russia they are generally small. If a certain volume of resources is deliberately allotted to capital development, which is to be undertaken without any regard to available funds, or price rises, or indeed anything, then clearly no alteration of wage rates or other financial manipulation can increase the real income available for consumption. Nevertheless there is almost certain to be pressure brought to bear on the State to grant wage increases "to compensate for the increased cost of living", and these are liable to be granted. Needless to say, if they are universal the process is simply one of chasing your own tail—there are no more goods available, so either prices rise in proportion, or if they are held fixed, the new incomes are unspendable. To some extent this is what happened during the first Five-Year Plan and the result was simply to produce financial chaos and dislocate the basis of the unit of account, without doing anyone much good. It did have some other effects, because the rise in wages was not the same in all cases and in particular it did not apply to the "wages" derived by peasants from their sales at fixed prices; this led to a certain redistribution of incomes, and the process was carried further by the arbitrary diversion of supplies to the towns—the peasants might get fabulous prices on the open market, but they could do nothing with the money.

Fortunately for everybody concerned, the Bolsheviks put a stop to this useless process, and introduced the various safeguards against reckless expenditure which I have endeavoured to describe. Had they not done so

eir whole system of accounting and control would ıve broken down, for the prices fixed by the com- ission would not have covered the increased wage ›sts, and all development grants would have proved ıadequate. We should have had in fact something like ıe chaos of an ordinary inflation, with the added 'ouble that many operations were in the hands of State fficials, who would have refused to accept the re- ponsibility of acting against their original orders. As it s, the Bolsheviks have arrived by a series of adaptations .t a system which is at least workable, even if not ideal; he value of the unit of account has decreased in the process, and this renders any comparisons with previous years more difficult, but it creates few enduring com- plications, as the debtor-creditor problem practically does not exist. Perhaps the greatest step forward was the realization of the need for an element of elasticity in the system, and the consequent introduction of the commercial shops; by allowing prices in these to move the Bolsheviks provided an outlet which was easily adjustable to the size of the public's "surplus" money income, and at the same time virtually guaranteed the adequacy of the State's revenue.

Despite the adoption of an apparently very rigid con- trol of expenditure and a genuine anxiety to keep down the note circulation, the main problem before the Bolsheviks is still how to exert sufficient deflationary pressure on industry to secure economy in the use of resources of all kinds, but particularly of labour. Russia's system, thanks mainly to its inflationary bias, has been admirably successful in preventing the waste of her

labour resources through unemployment; but the same inflationary bias is largely responsible for the prodigal way in which part of them has been employed. Money has been so readily forthcoming to ensure that everyone should be employed on something that the general attitude has been "Will this man's labour be of any use here?" rather than "Will it be of more use here than elsewhere?" This has been the case more especially on construction work, where it is particularly hard to secure efficient control and where the rule has often been "Get it done as quickly as possible, and never mind the cost". But even in the production of consumption goods far too little attention has been directed to weighing the merits of alternative courses. The starved state of the Russian market has in practice guaranteed a ready sale for almost anything, and if necessary the commercial shops could always add a smaller percentage than usual to the cost. As a result production has been planned on a somewhat arbitrary basis and without much conscious consideration of the principles of interpreting demand; indeed the Bolshevik planners seem to have very little conception of demand *at a price*, but regard it as something absolute. After an interview with some members of the planning department a somewhat disillusioned economist described their methods rather after this style: "If there are x people in Russia, each of whom needs y pairs of shoes per year, then the annual output ought to be $x \times y$ pairs; unfortunately we cannot produce nearly as many as that, and the same is true of most other commodities; so we will just do our best and get as near to the proper

ount in each case as we can". This was doubtless an ggerated version, but it is almost certain that the ortage of goods has not led, as it should have done, to y careful planning so as to avoid any misuse of the nited resources available, but rather to the simple ctrine that anything which may be produced will be dly needed, so there is no need to worry unduly about iicely calculated less or more".

If these shortcomings were simply due to failure of e personal element, there would be little more to say the subject, since this essay is not concerned with aborate calculations of the degree of success attained practice; but it is fairly clear that the system itself is t least partly responsible. As we saw in the Chapter on he Interpretation of Demand, it is not impossible for he authorities to deduce the public's preferences from comparison of costs with the prices people are willing o pay in the commercial shops; but there is no automatic device to secure the application of this test, and he shortage of goods has tended to stultify it. For if more of one commodity is being produced than is economically desirable the manager of the commercial shops will not insist on reducing their purchases of it simply because they cannot make such a big profit on selling it as they do on other things—they will be too afraid of not getting an adequate substitute; whilst it is a decidedly cumbrous process to secure an increased amount of an article which is in particularly short supply. In the absence of a system whereby relative over-production was made painfully obvious—*e.g.* by the appearance of a loss in the accounts of the producing

organization—it is probable that decisions on what to produce will continue to be made somewhat at haphazard; it is too dangerous to rely on harassed officials to stir up trouble merely because of a relatively small (but absolutely large) rate of profit.

APPENDIX

SOME INTERNATIONAL CONSIDERATIONS

ɪᴏᴘᴇ that it is now clear why no single answer can be ⁊en to the question "What is the value of a rouble?"; e object of this appendix is to give some indication of ıat values we should attribute to it in order to inter- et rouble statistics, where that is at all possible, and examine any exchange rates that may exist. Even if a ally full investigation were made it would be impos- ble to give any very accurate figures; but it is not as ffıcult as it might appear to give estimates which will, ı some cases, at least convey the order of magnitude of ıe sum involved.

There are several purposes for which a sterling quivalent is useful, and one major one for which it is ot. To begin with the latter, it is absolutely futile to try ɔ compare real wages in Russia with those earned broad by converting figures of rouble wages. Conditions re so different that it is doubtful whether any useful omparison can be made by any method:[1] but it is ertainly useless to compare the Russian worker's

[1] Besides all the usual difficulties we ought to make some allowance or the limited range of goods available in Russia, for the family rovision through increased rations, for the share of everybody in he new construction performed by the State, and for many other eculiarities.

money wage with that of his foreign counterpart, because it is not itself homogeneous. As we have seen many times, it is made up of one part which may be spent in the closed shops, and another which may not, and the proportions vary in different cases. We might perhaps establish exchange rates for each part, and so convert the whole into some foreign currency; but the privileges attaching to the first part vary so much that we should need a different rate for each individual.

The most important thing we can do is to attribute a sterling equivalent to the rouble as it is used for purposes of accounting. As we have seen, this unit of account serves as a basis for a costing system which is reasonably consistent, and the budget is also for the most part drawn up in terms of it, so that an estimate of its value, however rough, is very valuable. Since nearly all costs can be reduced ultimately to wages we shall get a very reasonable measure of its value by comparing the level of money wages in Russia with that which prevails in countries of similar wealth and at a similar stage of development—the peculiarities about the value of the wage to the recipient are immaterial. I do not pretend to have done this at all elaborately, and in any case it is not capable of exact treatment; but I would suggest that a figure between 25 and 35 roubles to the pound gives about the right order of magnitude. This figure must necessarily be used with very great caution in any individual case, because the Russian costing system is by no means perfectly consistent; but if it is announced that 30 million roubles are to be invested in building a water-

works, then we shall not in general be far wrong in thinking of it as equivalent to about a million pounds. At any rate, if the alternative is to confess complete ignorance as to its meaning, the figure is better than none at all—whereas this might not be so if we tried to give a single figure for making wage comparisons.

Since prices in closed shops are based on this costing system, it might seem legitimate to use the same rate for estimating the value of 30 roubles' worth of goods bought there. This is, however, distinctly more dangerous, because the State adds a variable turn-over tax to the costed prices of the various articles. Consequently we may get very different rates for different commodities; in any case there is so little freedom of choice allowed to customers of these shops that a general rate of exchange is not very useful—it is simpler just to note what the person is allowed to buy, and count that as part of his income. As regards the prices in the commercial shops, I found that in Moscow you would be able to buy about as much with 180 or 200 roubles as you could with one pound in England; on small things, however, the rate was considerably lower, even allowing for the inferior quality of many of them—perhaps about 100. Consequently if a Russian finds 100 roubles in the street, it will generally be worth rather more than 10 shillings, because he will as a rule have exhausted his "rations"; he might, however, spend it on tram rides and the like, when it would be worth much more.

If we want the official value, the Gosbank publishes every day a table which purports to give the rates of

exchange between the rouble and other currencies. This is compiled by taking the value of gold in terms of the pre-war rouble, and the price of gold in each country, and dividing the one by the other; since a pound was worth about $9\frac{1}{2}$ roubles before the war it now appears as worth rather less than six (because of its depreciation). Needless to say, this figure has absolutely no relation to the rouble discussed in this essay, but it is of importance in two ways. Firstly, the Bolsheviks will not officially admit that the rouble has any other value; and secondly, all imports and exports are valued in terms of roubles by converting their valuta prices into roubles at these rates. As a result of the latter it is perfectly simple to convert rouble figures for foreign trade into sterling by means of the official rate; in effect they are gold figures, and the unit is generally called a gold rouble.[1]

Finally, we ought perhaps to mention the "black bourse"; this is of course wholly illegal, and the rate consequently varies fairly substantially. In Moscow, however, it is generally possible for those who know the ropes to get about 200 roubles to the pound—*i.e.* about thirty times the official rate. This ratio is about the same as that between paper rouble prices in the commercial shops and gold rouble prices in Torgsin (which are about on the same level as world prices), and seems to move with it; this is of course to be expected, because the dealers in black roubles have the

[1] These rates are also used in Torgsin and other places where payment must be made in valuta; prices are fixed in terms of gold roubles, and converted into foreign currencies according to the table.

alternative of buying in Torgsin or the commercial shops. This does not mean, however, that the rouble is depreciated in this proportion; the black-bourse rate does not measure purchasing power parity in any sense in which that phrase is usually understood.

NOTE ON THE DERATIONING OF BREAD

TOWARDS the end of 1934 a number of laws were published which introduced considerable modifications in the Soviet financial arrangements, the most striking being the abolition of bread-rationing. These laws, which came into operation at the beginning of 1935, were hailed by some as bringing about a substantial amelioration of the lot of the Russian people, but others sought to prove that the rise in the price of bread would actually leave many of them worse off than before. The object of this note is to examine the principles involved rather than to assess the actual results; we shall find that the changes were primarily important as leading to a simplification of the technical part of Russia's financial system, and that of themselves they have surprisingly little effect on the general population—though they may well be symptoms of an improved position.

In brief outline the changes which directly affected the population were as follows. Bread and various other cereal foods were henceforward to be sold in the co-operatives and in the commercial shops without limit, at a single price intermediate between those previously ruling in these two markets. This single price was not to be the same in all parts of the country, but was fixed

separately for each of eight zones; the highest price, 1·60 roubles per kilogram of wheaten bread, was to apply in the Far Northern zone, and was nearly double that laid down for Central Asia (0·90 roubles). The latter was fixed specially low to encourage the cultivation of cotton, but otherwise the scheme of prices seems to bear some relation to the relative costs of producing bread in the various regions; whilst it would be unduly optimistic to say that this basis was scientifically applied, the prices are probably not as arbitrary as they appear at first sight. Alterations were also to be made in the prices of most other goods, the general effect being to reduce prices in the commercial shops and increase them in the closed shops. To compensate them for the increased price they would have to pay for their rations (especially bread) the lower-paid workers received an increase in their wages of about 10 to 20 per cent, and similar arrangements were made to compensate the peasants who sold their products to the State or co-operative organizations at fixed prices—these payments being rightly regarded as comparable with piece-wages. The increases in wages were not uniform, and only applied to the lower-paid workers. Generally speaking they were designed to leave the real position of the recipient more or less unchanged—thus a manual labourer in heavy industry would receive a greater increase than a clerk earning the same pay, because he previously enjoyed better rations, and so lost more through derationing.

In estimating the effects of these changes it is essential to remember one fact, which is extremely simple but

of dominating importance—namely, that the changed method of distributing bread to the public cannot of itself affect the amount available to more than a trifling extent. It may be a sign that the government has more to distribute, and therefore feels that it can sell freely, or even that it has less, and prefers to let prices rise rather than fail to supply the amount allotted on ration cards; but it cannot of itself be a *cause* of either of these things. It is true that the government may be induced to export less in order to redeem its promise of unrestricted sales, or that the new system may in some way affect (favourably or unfavourably) the percentage of grain which is wasted on the way to the bread counter; but these are only minor qualifications of the type which should accompany almost every economic proposition, and we may safely assume that for this year at least (since the harvest had been garnered before the change was even announced) the total supply of bread will be unaffected. The inability of any financial jugglery to alter this fact should on no account be forgotten, either by those who see in the increased prices yet another infamous exaction by the Bolshevik tyrants, or by those who regard the wage increases and freedom of purchase as further evidence of the beneficent workings of the Communist régime.

It is clearly possible, however, that the change might affect the distribution of the national income between different individuals and classes very materially indeed. Suppose, for example, that all rationing had been abolished without any change in money wages; then obviously the people with large money incomes would

have gained at the expense of the poor, because the latter previously spent a far greater proportion of their income on rationed goods. Similarly those people who had previously enjoyed unusually good rations would lose relatively to those with the same income but poor privileges—their advantage being in fact completely wiped out. Under the government's scheme, however, there seems to have been comparatively little redistribution of income in this way, though some previous anomalies have been corrected and doubtless others created. The Bolsheviks announced that they did not intend the State to make either a profit or a loss on the change; the net increase in revenue from the sale of bread was just to counterbalance the increase in money "wages" (including payments to peasants for deliveries at fixed prices), and the increased charges for industrial goods in the closed shops were to offset the reductions in the commercial prices.

It will perhaps make the essential principle clearer if we consider a very much simplified example, ignoring the changed prices for goods other than bread, and assuming that the wage increases just compensate the lower-paid workers for the rise in bread prices. The effect is that the poor man who previously bought his daily loaf in the closed store for half a rouble now receives an extra half-rouble a day in wages, and pays a rouble for his loaf; whilst the rich man who previously bought one loaf in the closed store for half a rouble and another in the commercial shop for one and a half roubles now buys two loaves at a rouble each, his income being the same as before. Thus the position of both is

unchanged and so is that of the third party (the State), which pays out an extra half-rouble a day in wages, but gets it back by charging a higher average price per loaf of bread sold.

This aspect of the matter is by far the most important, and has the merit of being quite straightforward, though things will not of course work out as simply in practice as in our imaginary example. There are, however, other considerations which are of interest, both theoretically and practically. In particular, is our assumption that both the rich man and the poor man will buy the same amount of bread under the new conditions really valid, or are those critics right who argue that the Bolsheviks will be unable to satisfy the unrestricted demand at any "reasonable" price? It is perfectly true that each will have the same amount of money left over after purchasing the old amount, but further supplies can now be had for a rouble a loaf, instead of one and a half; will not this lead to an increased demand, which may necessitate the reimposition of restrictions? The Bolsheviks were apparently aware of this possible danger, and were said to be ready if necessary to furnish extra supplies, presumably at the expense of exports; but there are three reasons for expecting the difficulty not to be important, and in point of fact it does not seem to have arisen. Firstly, the demand for bread is highly inelastic, so that the reduced price for additional supplies would not lead to a great increase in demand; if supplies had previously been hopelessly inadequate, then this inelasticity of demand would have necessitated an enormous increase in price before restrictions could be removed,

but this was not the case. Secondly, the prices charged for other goods in the commercial shops were lowered at the same time, though not so substantially; this partially offset the reduced price of bread as a stimulus to demand. And thirdly, there were previously cases where people were allowed to buy more bread in the closed shops than was really desirable; they could get it so cheaply that it was worth their while to do so, but on the price being raised they would buy less, even though their income was also raised. The elimination of this type of waste is of course thoroughly desirable, and is one of the indisputable advantages of the new arrangement.

Another benefit which has been derived from the abolition of rationing is the reduction of the time spent in queues and the generally increased convenience of shopping. Several factors have contributed to these happy results. Thus it is no longer necessary to check up the customer's right to buy his bread, and he can go to whichever shop is most convenient—there is no need to go on from the cooperative to the commercial shop for an extra loaf. The increased scope for competition should stimulate efficient methods, which were frequently notable for their absence, and managers of shops will have to study the convenience of their customers. Furthermore, there will no longer be so much queuing due to fear that supplies will be short in the particular shop where customers are allowed to purchase. A good deal of queuing in Russia was probably unnecessary—people were afraid that supplies would run out, so arrived before the shop opened to

get a good place and ensure that they would not be the sufferers; now they can at least try another shop if one has sold out, so that the need to arrive early is considerably reduced. If a feeling of confidence in the adequacy of supplies is really established, then there will no longer be any need to waste time in this "precautionary" queuing.

This feeling of greater confidence should lead to a welcome increase in the population's respect for the rouble; it is only natural that the average man should prefer a currency with a single value, even if his reasons are not quite as sound as he imagines, and the Bolsheviks have announced that if the derationing of bread turns out satisfactorily, then the process will be carried further. This will make the rouble less of a mystery to the man in the street, who is apt to regard the present system as a series of devices for cheating him of his just reward; in particular, it may lead to an increased willingness to accumulate savings in monetary form (*e.g.* savings-bank deposits) instead of by hoarding goods, which must always be a wasteful process. In this and other ways the new system should lead to small but welcome improvements in the amenities of Russian life, and increase the average man's confidence in the good intentions of the government.

So much for the effect of the change on the general population; it is probably safe to say that the government would not have introduced it unless they were convinced that the emergency was passing, but of itself the new system makes comparatively little difference, even in the distribution of the national income. Such a statement must not of course be pressed too far—there

may be individuals who are affected very materially indeed—but broadly speaking the effect is to produce a series of welcome alleviations, but nothing epoch-making; the Bolsheviks have simply devised an improved method of producing much the same result. It is perhaps interesting to observe that they considered it easier to reach a new equilibrium by raising the wages of the lower-paid workers to compensate for higher prices, rather than by reducing those of the high officials and leaving the average price-level unchanged; deflation and wage-cuts are unpopular even in a country where the State is almost the sole entrepreneur, the debt structure is undeveloped and the population have had unrivalled opportunities of learning that it is real wages which matter.

On the technical side the change has led to sounder methods of accounting, and a corresponding improvement in the rouble's basis as a unit of account; it has called for a truly astonishing number of adjustments, but it is not improbable that an overhaul was advisable in any case, and once they have been made the new system should be distinctly superior. As an example of the anomalies which existed under the old system, grain and other agricultural produce were supplied to the army (and other State institutions) at prices based on the very low rates paid to the peasants for their compulsory deliveries; this meant of course that the real cost of maintaining the army was considerably understated. Since its size is largely decided by non-economic motives this was not a matter of supreme urgency—especially as it does not sell its services, so that the

basis of the unit of account was not seriously prejudiced. But the situation was unnecessarily artificial, and liable to lead to waste. Thus it must always be the duty of those in charge of the army to run it as cheaply as they can, consistently with efficiency; but if they could obtain some goods at artificially low prices, whereas full costed prices were charged for others, then clearly their basis of comparison was hopelessly unsound. It may of course be true that such comparisons were seldom necessary, so that the damage was not really very great; but there is no point in running unnecessary risks, and in the new budget the army is charged the full price for all its supplies. It is now possible for the government to see what the defence services really are costing, without having to make a series of elaborate adjustments; the extra expenditure is balanced by a corresponding increase in the revenue from the tax on grain-collecting organizations.

This is typical of the sort of useful reform which has been effected; improvements in book-keeping cannot of themselves produce startling results, but a system under which the accounts really give a true picture of the facts reduces the need for supplementary control at all points, and may disclose the possibility of important economies. The problems which had to be solved before the change could be effected fall roughly into two classes, recurring and non-recurring; the former includes the establishment of a new system of prices to correspond with the increase of wages, whilst the latter is mainly concerned with revaluation of stocks and the adjustment of outstanding credit.

The general principle of the new system was that the tate would gain a sufficient net increase in revenue om the sale of bread and cereals to balance the increased wage-payments, and that the reduced prices for ndustrial goods in the commercial shops would be ffset by increases in the closed market. If the State nanaged all its affairs in one enormous trust there would e comparatively little need for adjustments to put this rinciple into effect; since, however, it works, and must lways work, on the basis of financially separate units, very elaborate arrangements had to be made. Thus the increased revenue takes the form of very substantial payments to the treasury by the grain-collecting organizations, representing the difference between the price paid for compulsory deliveries and the "economic price" charged to milling organizations and other purchasers. This is partially offset by the correspondingly enhanced cost of the army and other State institutions, and by the reduced profits on the sale of bread in the commercial shops, but a sufficient surplus remains to cover the increased wage-bill (including, as before, payments to peasants at higher fixed rates). The problem still remains, however, of devising new financial arrangements whereby this increased budget revenue shall be transferred to the factories, etc., which actually pay the higher wages; this is done by the treasury's reducing the taxes levied on industry to the desired extent, and by establishing a new scheme of prices.

The new scheme of prices is based on exactly the same principle as the old one, namely, that of covering planned costs plus planned profits at each stage of

manufacture. If we start at the bottom, increased prices are paid to the peasants by the organizations collecting raw materials, such as cotton; the price charged by these to the spinning-mill will have to be raised to cover not only this, but also their increased wage-bill and that of transport agencies, etc., and probably increased costs due to higher prices for equipment. This process is continued right through the system, until we get a complete new scheme of prices, higher than the old one, but based on the same principle. It is obvious that a theoretically perfect adjustment would call for extremely careful, and by no means easy, calculations of the effect of the various changes on costs, even assuming that the old scheme was accurate; in practice of course such refinements have not been attempted—new prices have simply been laid down which would roughly allow for the change, and they will (or may) be revised in the light of future experience. The old price scales were certainly not so perfect as to deserve retention if a better basis could be adopted.

The total cost apart from taxation of producing the output of industrial goods will have risen by the amount of the wage increases, and this is the amount which the treasury is prepared to remit in reduced taxes. It would have been possible to reduce the turn-over tax, so as to leave the prices in the closed shops unchanged, but the Bolsheviks preferred to let these prices rise more or less in accordance with the rise in costs, and concentrate the relief on the commercial shops. In this way their policy of working towards a single price-level has been materially advanced. The effect on the population as a

hole would of course have been much the same under ither alternative, because the same amount of goods ould have been sold at the same average price; the nethod adopted has the effect, taken by itself, of favouring the better-off section of the community, but this is upposed to be offset by the increases in money wages. Since the goal of a single price-level seems to be a lesirable one it is probably better to make the wage ncreases sufficient to compensate for the increased cost of all rations, rather than to confine the adjustments to bread; in addition, as we have seen, the general lowering of prices in the commercial shops is a useful safeguard against an excessive demand for bread.

It remains only to investigate the non-recurring problems of how to deal with revaluations of stocks and outstanding credit. The Bolsheviks seem to have devoted considerable attention to this problem, but unfortunately their exposition of the procedure to be adopted is somewhat confused; consequently it is only possible to see what they were aiming at, and to give an outline of the methods used. As in the adjustment of prices, their object was simply to devise a scientific way of adapting their system so as to retain the same financial control over the individual undertakings. Since all the undertakings belong to the State it has no need to consider questions of equity or of giving each factory a "fair deal"; with few exceptions (*e.g.* surplus profits accumulated through efficient working) it is dealing with its own property, and can make whatever arrangements seem expedient.

So far as stocks were concerned, it was obviously

necessary to revalue these as soon as the new prices were introduced, because otherwise all enterprises would make a series of small "unplanned" profits as they disposed of them, and these might mask any losses due to inefficiency. A decree was therefore issued that all stocks and work in progress were to be revalued in accordance with the new prices as soon as these became effective; with the best will in the world it could only be done approximately, but the result would be better than letting things drift. As a consequence of the revaluation all enterprises showed a windfall paper profit, and the decrees described at great length what was to be done with this. In the first place, profit arising out of stocks held with the enterprise's own capital (which was supposed to cover its minimum requirements, or so-called "normativ") were to be retained by the enterprise and added to its capital; this was clearly essential, for it would in future require that amount of additional working capital to finance its minimum stocks. Secondly, profits arising out of stocks held with Gosbank credit were to be offset by writing up the amount of the debt by a corresponding amount; this was also sound, for otherwise the enterprise would have been left with an unearned profit when it sold its excess stocks and paid off the debt. Thirdly, all profits derived from goods held in other ways were to accrue to the treasury; it is a little difficult to see quite what is visualized here, because theoretically an enterprise has no means of obtaining credit except from the Gosbank; however they probably do do so in various ways, possibly by borrowing from various funds under their control, and this provision is designed to

ısure that they do not make a profit out of their ıisdeeds. To this extent the rule is obviously salutary, ut it is impossible to judge it properly without more ɔmplete information; in so far as it penalizes enter-rises which have accumulated profits earned by effi-ient working it appears to be somewhat inequitable.

As regards future borrowings, it is obvious that credit mits must all be raised to correspond with the increase n prices; this cannot be done by making a uniform per-entage addition, because the increase in prices varies vith different commodities, so that each case must be reated on its merits. A less obvious point is that any nterprise which held abnormally small stocks on the ppointed day will no longer have sufficient working apital to finance its normativ, because it cannot revalue he bank balance which represented part of its capital. Failing a grant of additional capital it will therefore require still more credit; since, however, it is a cardinal point in the Soviet system that each enterprise should have enough working capital to cover its normativ, a grant will probably be forthcoming. There would be no difficulty in finding the necessary funds because the Gosbank has acquired a large paper surplus through the writing up of its loans; indeed this is probably the real meaning of a rather obscure part of the official explana-tory article dealing with this subject, but the Russians (perhaps not unreasonably) do not draw very sharp dis-tinctions between grants and loans, except where these are purely temporary.

This by no means exhausts the technical points which have arisen, but is perhaps sufficient to illustrate the

problems involved and the way in which they have been tackled; that the reform should lead to improvements in the financial structure seems reasonably certain, and it seems to have been carried through in an efficient manner. The point which calls for most criticism is the decision to encourage cotton growing by means of a concealed subsidy (the low regional price for bread) rather than by paying the growers a higher price; otherwise the new system should lead to a welcome simplification of Russian costing and accounting, and a corresponding increase in its reliability and usefulness. That the immediate effect of the change on the population was so small need cause us no surprise, for the government are neither tyrants seeking to add to the burdens of Russian life nor magicians with the power to produce bread from stones; the whole episode adds one more to the illustrations provided by Soviet economics of the importance of a monetary system which is technically efficient, and of its inability to work miracles.

THE END

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